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Harvey McGehee

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JUDGE ALEXANDER

Mississippi Law Journal

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JULIAN P. ALEXANDER—A MEMORIAL

*Harvey McGehee**

Sentiments of the most sacred nature surge your souls and mine on this occasion. It reminds us that from the ever-shifting throngs one by one we each must pass, that from the ever-surging masses day by day a face is missed, a voice is stilled, and that hour by hour new souls are freed to hear the divine chords sounding their celestial symphonies.

It is befitting indeed that we of the Bench and Bar should pause for a time this morning in the work of the Court and open again the portals of memory to view in retrospect the life and character of one who has wrought so nobly among us as a distinguished member of the Bar, as an eminent jurist, and as a truly great Mississippian.

During the closing days of the old year of 1952, the one subject, above all others, that engaged the thoughts and provoked discussion among the friends of the University of Mississippi throughout the state was the great football classic to be played on New Year's Day at Tulane Stadium in New Orleans. Their anxious hearts had chided that lagging hour. Among the many thousands who had journeyed there to see the great team of his Alma Mater play against its formidable foe from Georgia Tech was our genial friend, lover of clean sports, learned jurist, and prince of gentlemen, Judge Julian P. Alexander. While his beloved wife and children, of whom he was so justly proud, were seated near him in the stadium, and as the game was drawing to a close, with the last hope of victory for his favorite team gone, an unannounced guest, unbidden, visited the scene and pressed down his tired eyelids into dreamless slumber and eternal rest. In the irremediable darkness of such a gloom, many of his friends were prone to question why this should have happened, and loving words fell palsied from human lips.

From the very moment that this sad news was flashed to Jackson and to Mississippi, it is significant that scarcely any further discussion of the ball game and its unfavorable result took place here in the hotel

*Address by the Chief Justice of the Supreme Court of Mississippi, delivered at the memorial services held in the Courtroom on January 19, 1953, for Justice Julian P. Alexander.

lobbies, on the sidewalks, in the stores, and about the Capitol for the next two or three days. Mississippi had lost the Sugar Bowl game to Georgia, but the chief concern of the people of the City of Jackson, the County of Hinds and of the State of Mississippi was that we had lost Julian Alexander.

In groping for fitting words of eulogy to pay a just and adequate tribute to him, and to express the full measure of the devotion and esteem in which he was held by us all, I have not been troubled with any fear of having to indulge in indiscriminate eulogy or unreasonable praise. On the contrary, I have been disturbed chiefly with an unaffected distrust of my ability to meet the demands of this hour, to find words sufficiently simple in their sublimity and sufficiently sublime in their simplicity for the mere enunciation of his virtues. To that end, no flattery need be employed; only the truth need be spoken.

To adequately portray the qualties that gave him greatness and the virtues that made him immortal, I cannot; but with you I can reflect upon the chivalric purposes of his soul, his brilliant attainments, his memorable deeds, his lofty ideals, and the rectitude of his conduct both as a citizen and public official, which set him apart as one of God's noblemen, and which should inspire us to seek more diligently to pursue his chosen paths of manly honor and high endeavor.

In nature it often happens that a tree or plant transferred from its native soil to some far-away region attains a stronger, healthier, more vigorous growth than it would have enjoyed in its original locality. If a fruit-bearing tree, its fruit acquires a superior flavor. If a flowering plant, its blossom takes on a new beauty. But not so in the case of Julian Alexander. He was honored, loved and respected most here in the City of Jackson and the County of Hinds where he grew from childhood to manhood, and next throughout the State of Mississippi as he went on toward the zenith of his career of usefulness.

No one can be truly great unless he recognizes how unimportant his life is in comparison with the problems with which he deals. Wendell Phillips gave expression to this great truth when he said: "What imprudent men the benfactors of the race have been! How prudently most men sink into nameless graves, while now and then a few forget themselves into immortality!"

Speaking now briefly of the career of Julian Alexander as a judge; of his scholarly attainments as a man; of his personal charm and magnetism; and of his conduct as a gentleman to the manner born; and of his loyalty to his church and to the "faith of our fathers," I do so realizing full well that little can be added to further enrich the excellent eulogies contained in the resolutions that have just been read and adopted

or to what has been spoken by the representative of the state and local Bar here this morning, and to what was written in recent newspaper editorials, especially the great masterpiece written by the gifted and brilliant Editor of the Jackson *Daily News,* beautifully portraying the sunlit story of his days and telling of the genuine richness of his life. However, no member of this Court would want this occasion to pass without some contribution being made on his behalf, by each of them if time would permit or by at least one of our number, in token of the warmth and reality of our affection and great admiration for him as a fellow-member of this Court.

I make no invidious comparison in saying that I have never known a judge, during a period of fifteen years and more of service on this Bench, whose concepts of duty were higher or whose motives were more transparently pure and honorable. It seems to me that he approached the study and consideration of every case with a sincere desire to first determine what was the right and just thing to be done, and that he then sought to ascertain if that view could be sustained by the application of settled legal or equitable principles, but with an open mind to the disturbing truth that it is not within our power to administer equal and exact justice in every case; that we can render justice only according to the law.

We knew him in the quietude of his private office, enjoyed his keen sense of humor in the conference room, and appreciated the helpfulness derived from the presentation of his views in the time of trouble with legal difficulties involved in the solution of numerous cases. If he differed with his colleagues in conference, it was always in a deferential and diplomatic manner, because first of all he was a Christian gentleman. You will recall that scene in *The Talisman* where King Richard, just risen from a sick bed, with his two-handed sword severed a bar of iron, and Saladin with his scimitar divided the floating and flimsy veil of silk. Judge Alexander wielded the scimiter of Saladin rather than the sword of Richard, and the dexterity with which he handled it was a marvel to all.

It is not great to hold a political place. States do not erect monuments to men who have merely held an office. But Judge Alexander craved only the pleasure of doing; only the privilege of serving, and I fancy that if on New Year's Day in yonder stadium at Tulane, in New Orleans, when the shades of evening were falling athwart his pathway, he was permitted a moment for thoughtful reflection, there would have come before him no array of squandered opportunities, but rather the recollection of a life well spent in the performance of duty to his people and to his God would have risen like a constellation upon an evening sky to cheer and to comfort him.

For elevation of thought, for grandeur of expression, for beauty of language, there were but few, if any, living Mississippians who equaled him, while none excelled. He knew language as the devout Moslem knows his Koran. All of the depths and shadows of the sea of words were sounded and surveyed by him and imprinted upon the chart of his scholarly mind. He spoke with a fascination of manner and an elegance of diction peculiarly his own. He surpassed many orators in eloquence, most diplomats in wisdom and discretion, and the most ambitious in fame as a speaker at State Bar Conventions in this and other Southern States, and as an afterdinner speaker at civic clubs and on numerous other occasions, where his brilliant wit and unique style of expression kept him in great demand. His address before the Section on Judicial Administration at the American Bar Association in St. Louis in September, 1949, when it was my good fortune to attend, received universal commendation and unstinted praise from all who heard him.

The words with which he clothed his thoughts in his written opinions may have been studied, but his ideas and his judgment were fundamentally sound. In other words, he was more than a mere phrasemaker; he was in my opinion at his best in judicial conferences, where his views always compelled attention and usually carried conviction, even when spontaneously uttered. With his great dignity of bearing, with a countenance that evidenced great strength of mind and character, and with his charming personality, he would inevitably attract attention in any group.

But with all his culture of thought and speech, it ought, in justice to his memory, be said of him—and in the last analysis no greater praise can be bestowed upon anyone in public life—that he was essentially a faithful public servant.

The convictions that I have uttered here do not represent any hasty conclusions reached since I was asked a few days ago to speak on behalf of all the Members of the Court at these memorial exercises; the evidences of their truth have been accumulating during my acquaintance with him during a long period of years, beginning with our law school days, then as a fellow member of the Bar for a short time in the City of Meridian, and later I knew him as an Assistant United States District Attorney here in Jackson, and then as Circuit Judge of this district, and finally during a period of twelve full calendar years as an Associate Justice of this Court.

Last, but not least, it was well known that as a Sunday School teacher, Judge Alexander delighted to stand before a group of men from Sunday to Sunday and teach the eternal verities of the Bible, a book which from first to last concerns itself with the heart of man, and he believed

that he then and there had for his theme "the greatest story ever told," transcending in importance all legal questions, economic problems, and other issues of great magnitude that may engage the thoughts and minds of men.

He was no light conformist to the creeds of his church; he believed in them and they possessed him. He subscribed to the view that greatness and goodness are like twin born angels that move throughout the troubled elements of society as gently as the dewdrops on drooping flowers, and as softly as moonlight on midnight waters.

The influence of a good life never dies. Like the sun which "continues to shine when set," its fragrance lingers on the evening sky to soften and hallow the scene, enshrining sacredly its beneficences in our hearts. Truly it is that "the path of the just, like a shining light, shineth more and more unto the perfect day."

We shall forever cherish the precious legacy of his noble manhood.

ESTATE PLANNING

Joseph Berman and *Daniel S. Berman**

High estate and gift taxes require frequent changes of wills and yearly reviews of clients' estate plans to keep abreast of changes in the law; new interpretations by new regulations and surprising decisions are constantly being made. Everyone who expects or hopes to have any property left in his estate should re-examine yearly the effect of events on what he had reasonably expected would happen.

The 1948 Revenue Act puts a great premium on tax-wise estate planning that no client with an anticipated estate—including insurance—of more than $100,000 should neglect. However, estate planning involves more than a desire to reduce estate taxes. It includes a study of clients' assets from the point of view of liquidity, yield, quality, ease of administration, and tailoring of assets to the particular needs and capabilities of clients' beneficiaries. Sound planning is concerned with the distribution of a client's estate in exact compliance with his designs and intentions. A tax saving at the expense of the security or financial independence of the client's family is not worth its cost.

Taxes are one of the greatest dangers to estate conservation, and this analysis will attempt to show how to reduce estate taxes to a minimum. The problem is acute now since the 1948 Act has pointed the way—without changing the tax rates or exemptions—to large savings in federal estate taxes for those prepared to take proper action as previously described in our analysis.[1]

Preliminary Analysis

Estate planning involves the building up of the estate and the mechanics of its distribution after the death of the planner. We must therefore consider at once the estate tax consequences of our plan as well as that of income tax and gift tax results.

Our interest in such planning is governed by: (1) the client's desire to pass to his heirs as much value and control over his property as possible; (2) the client's desire to hold the greatest possible amount of wealth and control over his property during his lifetime; and (3) the client's desire and anxiety to meet his beneficiaries' requirements by an orderly transfer of his property on his death.

In estate planning it is important, in order that we may do a pro-

*Members New York Bar.

[1]For details, see Berman, *Reduction in Estate Taxes Resulting from Estate Planning,* 56 Com. L. J. 224 (1951).

fessional job, to obtain from our client the following information: (1) the client's domicile; (2) full particulars as to his assets and liabilities: their nature, extent and status; (3) full particulars of previous gifts made by the client; (4) particulars as to family group, their personal objectives and qualities; (5) an examination of all existing documents, such as (a) wills of decedents under which the client has any interest or powers of any kind; (b) inter vivos trust instruments (including life insurance trusts) signed by the client as settlor, whether or not he has reserved any interest or power of any kind, and similar instruments signed by others as settlor under which the client has any interest or power; (c) any prenuptial or separation agreement made by the client; (d) any decree of divorce or separation entered in favor of or against the client; and (e) an examination of the client's life insurance policies.

Before we devise our plan it is important that we make a preliminary analysis of the results which will follow from the present arrangement of the estate during the client's life and on his death. What is likely to be "on hand" at client's death, after administration of estate, and what will be the net amount left to the beneficiaries after all gift, estate and income taxes are paid?

In some cases the amount "on hand" will be easy to compute if the estate consists of cash and high grade listed securities owned outright under proper supervision, with no liabilities. It is then sufficient to assume the date of death, value the gross estate, estimate administration expenses, compute the federal estate and state death taxes according to current exemptions and rates, and arrive at the amount which will be available for distribution, and estimate its yield after income taxes.

Where the assets are not in liquid form it may be more difficult to estimate the amount of the estate at death. For instance, where assets are interests in partnerships, close corporations and real estate, all of the assets are not owned outright, or some are subject to encumbrances. There may be life insurance which was tinkered with. There may be property jointly owned or property held in tenancy by the entirety, or community property rights. There may be interests and rights granted to the client or the client's beneficiaries under wills of others, or reserved or granted to the client under inter vivos trust established by the client or others. And, there may be heavy liabilities, fixed and contingent, which should be considered.

In order to arrive at a proper conclusion it is advisable to study copies of the current federal estate and state death tax returns. Consider all the questions which might be presented on the basis of the existing facts before all the forms could be completed, and then roughly execute

these forms on the basis of what is most likely to happen under the existing arrangement of the estate.

A good deal of such an estimate is based on guess work as to what will happen to the client's business on his death, as to his then liabilities, administration expenses, funeral expenses, expenses of last illness, etc.

How much cash will have to be raised for death taxes and administration and where will we get it?

What will be the disposal of the proceeds of the client's life insurance and to what extent will it be available for death taxes, administration expenses, etc., so as to avoid any forced sale of assets?

What problems will confront us in the disposition of business interests and other special assets?

In what manner will assets pass: through the executor, or as a result of joint ownership, or by operation of a trust or other arrangements established prior to death, or the exercise of powers of appointment, or otherwise?

Answering these questions, we shall then be able to show in summary (1) how much net income (after the deduction of estimated income taxes) will be available to the client and the client's beneficiaries as a group under the existing arrangements; and (2) how much net income will be available to the group, pursuant to the existing arrangements, after the client's executor has completed his work.

What defects are there in existing instruments? Do they require judicial construction, or will they lead to litigation? Do their provisions violate local law as to accumulation of income or perpetuities? Do they fail to provide for likely contingencies? Do they fail to give fiduciaries necessary administrative powers? How do they meet the requirements of those interested?

Marital Deductions—The Revenue Act of 1948

The Revenue Act of 1948 extends to married residents of all states the tax benefits of the community property system which result from the ownership by each spouse of one-half of community property. It permits married testators to treat non-community property "as if" it were community property in computing taxes on income, gifts and estates. It repealed the 1942 community property amendments and allows a husband to transfer to his wife at his death one-half of his adjusted gross estate free of federal estate taxes. The marital deduction may be less than one-half of the adjusted gross estate, but cannot be more, and includes

both probate and non-probate property. The 1948 Act covers life insurance payable to named beneficiaries, assets held in joint tenancy, inter vivos transfers held in contemplation of death, and property in inter vivos trusts includable in the estate of a decedent by virtue of other requirements of the tax laws.

In planning for the marital deduction—maximum or less than maximum—the entire estate, probate as well as non-probate, must be programmed. Unless there is such correlation, the amount of the marital deduction cannot be estimated. Further, if more assets than necessary are allocated for the marital deduction an expensive duplication of taxes may occur.

The marital deduction is available in estates of married citizens or residents of the United States who died after December 31, 1947. The surviving spouse need not be a citizen or resident of the United States. It is available only in respect to interests which pass to a surviving spouse, and the status of the parties is tested as of the date of death. The marital deduction is available if the spouses were legally separated, but not divorced, at the date of death. An item in the gross estate which passed to a surviving spouse before marriage qualifies for the marital deduction if the parties were married on the date of death. The Commissioner may raise questions as to the validity of divorces and marriages.[2] The marital deduction is not available in the estates of non-resident aliens, even if the surviving spouse is a citizen or resident of the United States.

The marital deduction is computed as follows: From the value of the gross estate first is subtracted the total of the deductions allowed under Section 812(b) of the Internal Revenue Code for funeral and administration expenses, claims, liens, and casualty losses. The resulting sum is the "adjusted gross estate" and 50 per cent thereof is the maximum marital deduction. The marital deduction equals the total of the net values of the various interests which actually pass to the surviving spouse and which qualify for the marital deduction, subject to the permissible maximum.[3]

The net estate is then computed by subtracting from the gross estate the total of the Section 812(b) deductions, the marital deduction and any charitable deductions which may be available. The net estate so obtained is then reduced as heretofore by the $60,000 exemption. The tax rate is unchanged by the 1948 Act.

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[2]U.S. Treas. Reg. 105, §§ 31.47b and 31.47e.

[3]The items which make up the marital deduction are listed in a new Schedule M-1 annexed to the federal estate tax return. Form 706 MD sets forth the new schedule with instructions which should be examined.

The marital deduction is only available in respect to items found in the *gross estate,* and such interest may pass to the surviving spouse: (a) as surviving joint owner; (b) as proceeds of life insurance; (c) by intestacy; (d) by election to take against the will; (e) by bequest or devise; (f) by inter vivos transfer; (g) as appointee or taker in default of appointment. Foreign realty is not in the gross estate and not eligible for marital deduction. If the surviving spouse contributed all or part of the cost of jointly-owned property, or such property was acquired by the decedent and the surviving spouse by gift or inheritance, and therefore partly or wholly excluded from the gross estate, an interest in it would to such extent be ineligible. To the extent that life insurance proceeds are not included in the gross estate, interests in it are not eligible. In the case of inter vivos transfers, qualified interests would arise only if the transfer was in contemplation of death or includable in the gross estate because of powers or interests reserved by the decedent or because the transfer is otherwise effective at death. In respect to appointive property, qualified interests would arise only if the property was subject to a taxable power of appointment.

Marital deduction is not available as to an interest if it is a "terminable" interest and fails to meet the tests and exceptions described below, or if it is a terminable interest which the decedent directs his executors or trustees to acquire, even if otherwise it would be deductible terminable interest.[4]

The deduction must be diminished: (1) by amounts payable therefrom which are also allowed as other deductions, as for mortgages or other liens; (2) by amounts which pass to the surviving spouse in satisfaction of a deductible claim of such spouse against the estate, and (3) by the amounts of death taxes which are payable from it. Otherwise there would be double deductions or deductions in respect to sums which did not pass from the decedent.

Terminable interests are ineligible for marital deductions: (1) if any other interest in the same property has passed or may pass at any time from the decedent to any person other than the surviving spouse; and (2) if such other interest has passed or may pass from the decedent to such other person for less than an adequate and full consideration in money or money's worth; and (3) if by reason of such passing such other person, or his heirs or assigns, may possess or enjoy an interest in such property after the termination or failure of the surviving spouse's interest in such property.[5] Terminable interests qualifying for the marital deduction are

[4]INT. REV. CODE § 812(e)(1)(B)(iii); U.S. Treas. Reg. 105, § 81.47b(e).

[5]Other terminable interests not affected by the above factors qualify for the marital deduction as shown by illustrations in U.S. Treas. Reg. 105 § 81.47a(b).

as follows: (1) trusts giving the surviving spouse all the income for life and a general power to appoint the corpus; (2) dispositions of life insurance proceeds to be held by the insurer for the benefit of the surviving spouse; and (3) interests which may fail or terminate by operation of "common disaster" clauses.

The marital deduction is not available if the gross estate consists entirely of community property. Because of the repeal of the 1942 community property amendments, only one half of the community property is included in the gross estate of the spouse who dies first even though the decedent accumulated the greatest portion of all of the community property. If the gross estate consists of one-half of the community property plus separate property, the one-half of the community property, and the pro rata part of the Section 812(b) deductions allocable to it, are excluded in computing the adjusted gross estate.[6]

There may be community property in a common law state where the spouses were married abroad and adopted a regime of community property under the law of the country in which they were married. In such a case, their property continues to be subject to the community property regime.

Marital Deduction And Gift Tax

For gift tax purposes, the tax benefits of the community property system were extended to married donors in all states by repeal of the 1942 amendments, so that gifts of community property are again treated as made one-half by each spouse. It grants a complete new deduction, a "marital deduction" in respect to non-community property by which a gift by one spouse to the other is treated as a gift of only one-half the donated property, and the other half is treated as if it was already owned by the donee spouse. The law permits either spouse to treat a gift to a third person as if one-half of such gift was made by each spouse, permitting the spouses to "split" such gifts. The law is the same as that applying to estate taxes as to terminable interests and reservations of powers to appoint.

Life Insurance

Life insurance is often the greatest asset in an estate, and it is important that we give it due consideration in the planning of large as well as small estates. It is, therefore, important in estate planning that we

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[6]The special rules to ascertain the maximum marital deduction in such cases, and in respect to separate property which was acquired by a decedent as a result of converting community property into separate property, are to be found in Int. Rev. Code § 812(e)(2) and U.S. Treas. Reg. 105, § 81.47d.

examine every life insurance policy covering the client.[7] The death proceeds of life insurance may be included if the insured was either the owner of the policies or paid its premiums.[8] The same rules apply to accident insurance, and if the wife pays the premiums its proceeds, if they become payable, will pass to her free of estate tax.

Bequests and Gifts to Client

It is important that we ascertain what property the client received by bequest, devise or inheritance on which a federal estate tax was paid, since if less than five years elapsed between the death of the first person and the receipt of the property, it may be important to keep it distinct and separate from any other property. Should the client die prior to the expiration of five years from the death of the person who bequeathed property to him, the client's estate will be entitled to a deduction (subject to certain limitations) for the property received, if identifiable as the property received or acquired in exchange therefor. If the bequest was in cash, a special account should be opened and no withdrawals should be made except for investment. If securities were received, and such securities are sold, a special account should be kept with the broker, so that repurchases can be traced to the proceeds of the inherited stock. After five years there is no advantage in continuing the special accounts. The same rules apply to inter vivos gifts which have previously been subjected to a gift tax. It is essential here, also, that we preserve identification for a period of five years.

The Client's Business Affairs

Advance study of all business agreements may help us in cutting down our planning problems. The client is interested in receiving an answer to the following questions: How will his choice of a business organization affect his estate and heirs at his death? What will happen to his business at his death? What is the effect of his business transactions that accrue at his death? Can his business organization be planned so that his heirs benefit from its advantages, and yet minimize limitations upon the use of any particular business organization?

The most common forms of business organizations are sole-proprietorships, partnerships and corporations. Each has certain advantages and limitations, and their use should be considered in proper estate planning.[9]

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[7]For a full discussion of the advantages and disadvantages derived under proper planning of life insurance and annuities, see Berman, *Federal Tax Advantages Derived Under Proper Planning of Life Insurance and Annuities,* 23 Miss. L. J. 210 (1952).

[8]Int. Rev. Code § 811(g); U.S. Treas. Reg. §§ 81.25, 81.27.

[9]For full discussion, see Vogel, *Partnership vs. Corporation Under the 1948 Revenue Act,* 18 S. Dak. Bar J. 122 (Oct. 1949).

A sole proprietorship usually ends with the death of the proprietor unless otherwise properly planned in advance, as by the proper training of his heirs to succeed him and with authority given to such heirs to operate the business during the administration of the estate. A trust company may be advisable as co-executor in these cases. It is also important that the client provide adequate funds to pay taxes at his death, and provide for administration charges and other expenses, so that the business may be passed on intact to administrators capable of running it. Life insurance can provide the cash necessary to continue the business as a going concern until sold at a fair price, to preserve it for the interested heirs, or to pay the necessary salary of a competent manager where the heirs are incapable of operating it. Otherwise, forced liquidation may destroy the assets.

There are a number of ways for the client to protect his family in sole proprietorship situations. One is through a qualified profit sharing trust and sales agreement in which the employees of the business share and participate. The employees' profits are to go into a trust fund.[10] The client proprietor enters into an agreement with the trustee of the trust for him to buy the business on the client's death at a pre-arranged price, or at its fair market value at his death, or at a certain price adjusted yearly as the business changes. To finance it the trustee insures the client owner's life for a sufficient amount to cover the purchase price. The premiums are paid by the trustee from the contributions of the business to the profit sharing trust. The trustee is the beneficiary as well as the owner of the insurance policy. The trustee is given authority by the contract to pay any liens on the assets of the business and to deduct it from the total purchase price. The balance of the insurance proceeds, if any, above the purchase price, is paid to client's widow, family, or heirs, in cash or in the manner directed by the deceased in the agreement. The trust agreement should allow the owner to contribute to the trust each year an amount exceeding the premiums of the policy in order to create a reserve fund with which to pay the premiums when the business does not earn enough profits to cover it.

At the client's death, the proceeds of the insurance policy are paid to his widow, family or heirs in accordance with its terms (usually in monthly installments), and the executor of the estate conveys clear title to the business to the trustee. The trustee may then hold the business for the benefit of the employees, or convey it to the employees in proportion to their individual interests in the trust fund, or incorporate it and distribute its stock to the employees according to their proportionate

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[10]P-H Pension Serv. ¶ 3065.

interest. The employees are thereafter the owners and operators of the business. Approval of the profit sharing trust and sales agreement plan should be obtained prior to its adoption from the Commissioner of Internal Revenue.

The advantages of the plan are as follows: (1) The client owner provides himself with a guaranteed market for the sale of his business at his death. (2) He transfers it to those most interested in its future existence, at a fair, pre-arranged price. (3) He arranges for the continuity of his business, personnel and management, which will bolster his credit while alive and that of his business after death. (4) The value of the business is fixed for estate tax purposes, which, if fair, will not be disputed by the government. (5) Its value and that of the policy will not be taxable in the client owner's estate.[11] (6) The premiums on the life insurance policy will be deductible by client owner for income tax purposes as contributions to a qualified profit sharing trust.[12] (7) This insurance will cost him a reduced rate; if the client is in the 60 per cent income tax bracket, he will only pay 40 per cent, the government the balance. This is one method of deducting premiums on personal life insurance.[13] (8) This plan increases employee morale generally, since the employees are certain of the existence of the business after the employer's death. Participating employees know, in addition, that they may be the owners of the business in the future. (9) The client owner increases the interest of employees in the future of the business and provides incentive for employee cooperation. (10) The plan provides for a reserve fund available to purchase the owner's interest should he desire to retire prior to his death. (11) It provides a cash fund to pay estate taxes and other debts of the owner's estate. (12) The owner's wife and family are relieved of business responsibilities and are guaranteed a source of cash or income (and a life income if so planned) instead of a speculative business investment.

In some cases partial sale of the business may be advisable, and retention of majority control by the owner's family may be best where heirs are capable of running it. A sale to key employees could be arranged. An installment sales plan might be desirable. Fixed assets can be rented from the heirs or family, thereby splitting the income into many parts and thereby reducing taxes. In some cases the installment sales plan is advantageous from the depreciation point of view and on the question of long or short term gain on its sale.

In the case of partnerships, unless the partnership agreement or

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[11]Estate of Ray E. Tompkins, 13 T.C. 1054 (1949).
[12]INT. REV. CODE § 165(a).
[13]POLISHER, ESTATE PLANNING AND ESTATE TAX SAVINGS 523-4 (2d ed.).

local laws provide for the continuance of the business, a partner's death ends the partnership.[14] In such instances the partnership must liquidate, at a severe loss to all the partners, unless advance plans obviate dissolution.

Properly planned buying and selling agreements may make it possible to assure each partner that on his death his family or heirs will receive, in cash, the value of his partnership interest as a going concern. This can be assured by private funds of partners, by life insurance or by loans of borrowing partners. Your client may wish to enter into a profit sharing agreement which will continue, his estate to share in the partnership profits after his death, where he otherwise has ample funds. Be careful of the tax consequences in drafting such an agreement, as it may seriously affect the income and estate taxes of the partners' estates, as well as the income tax of the surviving partners.[15]

Through the formation of family partnerships your client can save both income and estate taxes. Family partnerships are carefully scrutinized by the Internal Revenue Bureau, and recognized by it if, acting for a valid business purpose, the family members contribute capital or labor to the venture.[16] The partnership must not be a sham entered into for the purpose of evading taxes; it must have a legitimate, genuine business reason.

The death of one partner may dissolve the partnership for purposes of his estate, but it may not, for tax purposes, terminate the partnership accounting period for the surviving partners. They may not be required to "bunch up." The tax disadvantage to the estate of the deceased partner, where the partnership fiscal period varies from that of the individual partner's taxable year, compelling the estate of the deceased to "bunch up" may be avoided by proper tax planning. Provide in an agreement that the death of a partner does not dissolve the partnership, or have the partner's taxable year coincide with the taxable year of the partnership.[17]

In the case of businesses making substantial installment sales, the partnership form of operation should be avoided, since the entire amount of deferred profits on the installment sales of the business may, upon the death of a partner, become taxable to his estate and to the surviving partners as a distribution, transmission, or other disposition of installment obligations.[18] In such case use the corporate form of organization. The

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[14]40 Am. Jur., Partnership § 285 *et. seq.*
[15]Forster, *Partnerships and Life Insurance,* 24 Taxes 170 (Feb. 1946).
[16]P-H Fed. Tax Serv. ¶ 15, 511-29 (1953); Commissioner v. Culbertson, 337 U.S. 733 (1949).
[17]Guaranty Trust v. Commissioner, 303 U.S. 493 (1938).
[18]Waddell v. Commissioner, 102 F.2d 503 (5th Cir. 1939).

installment obligations owned by a corporation are not affected by the death of a stockholder, even if he is the owner of all the outstanding stock.

Fixed assets, such as factory, machines, trucks, etc., should be rented from the family or heirs of one or more of the partners, thereby gaining the same tax advantages enjoyed by a sole proprietorship, as previously explained in this article.

In planning a client's estate, the conversion of a sole proprietorship or a partnership to the corporate form entails some important estate planning factors during his lifetime which should be given proper consideration.

A client should make gifts of corporate stock to members of his family or others soon after incorporation in order to save income, estate and gift taxes. The value of the stock is probably lower than at any future date in a successful business. Minority stockholders of common stock and officers of close corporations can protect the interests of their heirs upon their death by stockholder agreements,[19] purchase of the corporation, purchase by the key employees, or sale to trustees.[20] In such "buying and selling agreements" of your client's stock interest, the price to be paid or a formula to be used in determining the value of the stock on his death should be embodied in the agreement. It is important that a fair price be set up in the agreement to forestall disagreement afterwards between the heirs and the government with regard to the stock to be included in the estate for estate tax purposes.[21]

Diversified capitalization is often advisable in estate planning where future heirs are inexperienced or disinterested in corporation affairs. They may thereby convert the ordinary interest income into a capital gain.[22] In such cases neither the cash basis bondholder nor members of his family may own more than fifty per cent of the corporation's outstanding stock. The bonds must be in registered form or have interest coupons attached thereto.[23]

Pension and profit sharing plans in the corporation afford your client stockholder-officer with a retirement plan for himself, and a life insurance policy on his life for the benefit of his family.[24] Advantages of corporate

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[19]PAUL, FEDERAL ESTATE AND GIFT TAXATION 1298-1302 (1942).
[20]P-H PENSION SERV. ¶ 3065-7.
[21]Lomb v. Sugden, 82 F.2d 166 (2d Cir. 1936); Wilson v. Bowers, 57 F.2d 682 (2d Cir. 1932).
[22]INT. REV. CODE § 117(f); Commissioner v. Caulkins, 144 F.2d 482 (6th Cir. 1944); 3 MERTENS, LAW OF FEDERAL INCOME TAXATION 703-10 (1942).
[23]INT. REV. CODE §§ 24(c) and 117(f).
[24] U. S. Treas. Reg. 111, § 29.165-1(a) (1943); Volckening, Inc., 13 T.C. 723 (1949); I.T. 4020, 1950-2 CUM. BULL. 61.

entity over sole proprietorship or partnership are continuity of entity, inter vivos gifts, and continuity of income and management controls.[25]

Contracts of accountants, doctors, attorneys and authors survive their death, so, to prevent double taxation in such cases, take advantage of Section 126 of the Internal Revenue Code or provide in the agreement that in the event of death their income be widely spread among their heirs.

Gifts in Contemplation of Death

In your estate planning, carefully avoid the pitfalls of the law covering "gifts in contemplation of death." Objective facts taken into consideration by the courts in deciding such cases are the size of transfer, age of the transferor, the relation of the date of gift to the date of death, the transferor's health, or a combination of the above facts.[26] What was the dominating motive? Was it tax avoidance, financial assistance, or freedom from responsibility?[27] Courts take into consideration whether the transfer was made to natural objects of bounty, and whether execution of a will was made contemporaneously with a transfer in trust.[28]

Rebuttal of the presumption that a gift was made in contemplation of death requires a preponderance of the evidence. The burden of proof is on the taxpayer if the Commissioner claims that a transfer was made in contemplation of death except where the question is first raised after Tax Court proceedings have begun. In such case the burden of proof of the affirmative allegation is upon the Commissioner; however, as soon as a prima facie case is made, the burden of proceeding shifts back to the taxpayer.[29]

Precautions should be taken in case it becomes necessary to rebut the allegations of the Commissioner. Examine every potential gift from the standpoint of "contemplation of death." If circumstances may raise any question, collect objective data contemporaneously which would tend to overcome the charge. Avoid action which invites the charge. Remember always that the possibility of the charge lurks in every gift made within five years of death. Protect against it by not taking steps which will invite the charge and arm yourself with facts to overcome the charge if necessary. If the alternative is, however, to make a gift which is in

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[25]Commissioner v. Culbertson, *supra* note 17; Helvering v. Clifford, 309 U.S. 331 (1940).

[26]Estate of G. L. Bradbury, 15 T.C. Mem. Dec. ¶ 46,219 (1946).

[27]Becker v. St. Louis Trust Co., 296 U.S. 48 (1935); Estate of Jacob Gidwitz, 14 T.C. 1263 (1950).

[28]Estate of William S. Miller, 14 T.C. 657 (1950); Estate of Emil A. Stake, 11 T.C. 817 (1948).

[29]Estate of N. Koussevitsky, 5 T.C. 650 (1945).

contemplation of death or not to make the gift, by all means make the gift even though in contemplation of death.

The Advantages of Trusts in Estate Planning

Trusts are a flexible device for providing for the needs of the family. Inter vivos or testamentary trusts can be used to a degree in avoiding estate taxes upon the death of successive life tenants, and to minimize income taxes within the family after the trustor's death. The revocable inter vivos trust has additional advantages. It provides for the trustor's comfort, relieving him of the management of his investment. By its revocability we can correct any weakness in the arrangement, or management prior to our client's death. We avoid executor's and guardian's fees usually incidental to testamentary disposition. It creates privacy which cannot be had where publicity is otherwise required on the part of the executor in accounting. It establishes continuity, stability and insulation.[30]

Tax Consequences of Inter Vivos Gifts

The income from donated property is subjected to income tax at the presumably lower rates applicable to the recipients of gifts. The gift tax rates are only 25 per cent of the estate tax rates. The given property is removed from the highest applicable estate tax rate brackets to the presumably lower gift tax brackets. Money used to pay the gift tax will not be subject to gift or estate tax, whereas the amount of the estate tax is not removed from the estate tax base. The grantor can utilize his lifetime gift tax exemption of $30,000, in addition to his $60,000 estate tax exemption. Except for gifts of future interests, each grantor is allowed an annual exclusion of $3,000 for each donee; and, with respect to transfers after April 2, 1946, a qualified gift to another than one's spouse may be treated as made one-half by each spouse, thus in some cases doubling the available lifetime exemption and annual exclusions as well as doubling the application of the most favorable gift tax brackets.[31]

Some advantages are that the donor parts with the property transferred as well as its income, and loses also the amount of the gift tax and the income which it would have produced. In general, certain prescribed testamentary transfers step up the basis of property which has appreciated in value, while normally an inter vivos transfer will not.

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[30]Commissioner v. Hagers Estate, 173 F.2d 613 (3d Cir. 1949); Estate of C. Dudley Wilson, 13 T.C. 869 (1949).

[31]Int. Rev. Code § 1000(f).

Testamentary Trusts

In planning large estates, we should consider the advisability of using testamentary trusts because that enables us to save income and estate taxes and makes principal available to beneficiaries. It is important in such cases that our clients exercise great care in their choice of trustees and provide for successor trustees; that they appoint guardians for infant beneficiaries, set forth management powers, provide for the requirement or non-requirement of bonds, provide for compensation for trustees where not provided for by law, and provide for trustees' accounting. The client should provide for beneficiaries in case of emergencies. The need for restraints upon alienation by beneficiaries and for spendthrift protection should also be considered.

The law of the state where a will is signed determines its validity. In New York a will is valid if it complies with its laws or the laws of the state in which the will was signed. Generally the laws of the state of domicile control. In Mississippi all testamentary charitable bequests are void,[32] in Georgia they are void if made within sixty days of death. In New York no person having a husband, wife, child, descendant or parent can devise more than one-half of his estate to charity and the parties aforementioned can contest the will.

Beware of the Rule Against Perpetuities limiting trusts in certain states. Where charitable gifts inter vivos are made, assets of highest value and lower costs, or assets assessable for estate tax purposes at higher than actual value, but which decedent does not desire to be sold, should be chosen, as well as assets which must be liquidated to pay estate taxes. The 1950 Act prevents any benefits accruing to the donor or his family from a charitable legacy or gift, and prevents exempt charitable organizations from competing with taxable corporations; only management functions can be retained and all dealings between charity and donor must be at arms' length.

Some prohibited transactions are: (1) the lending of the corpus or income without the receipt of adequate security and reasonable rate of interest; (2) the payment of unreasonable salaries or compensation for personal services actually rendered; (3) the making of any substantial purchase of securities or any other property for more than an adequate amount of money; (4) the selling of any of its securities or other property for less than an adequate amount of money; (5) the engagement in any transaction which results in a diversion of the corpus or income.

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[32]Nat'l Bank of Greece v. Savarika, 167 Miss. 571, 148 So. 649 (1933).

Charitable Bequests or Gifts

Charitable bequests or gifts are transfers of assets deductible for estate and gift taxes. The Internal Revenue Code[33] provides that transfers to the United States or political subdivisions for public purposes, transfers to a corporation, trust or fraternal society, or an association operating under the lodge system for charitable, educational, literary, religious or scientific purposes, including the prevention of cruelty to animals or children, where no part of the income is for the benefit of an individual or stockholder, and where no substantial part of its activities is the carrying on of propaganda or lobbying, are deductible for estate and gift tax purposes. Up to the present, deductions are allowed for donations to recognized educational institutions and religious groups, including those which aid in the general physical development of youth, even though membership or management is restricted as to race or religion. The Treasury Department frowns on such restricted gifts, but outright gifts are allowed. Gifts made preferring relatives, but not limited to them alone, have been allowed, but rests on weak ground and may be upset. Gifts to Masonic Orders, fraternities, community chests, varsity clubs, and the like, are not deductible, even where they were allowed as contributions for purposes of income tax deductions. Gifts to foreign charities are deductible only by citizens or residents.

Conditional gifts or bequests are not deductible unless they come within limitations previously mentioned. Deductions are allowed where the condition expresses a preference rather than a limitation.

A bequest to trustees or an organization to be formed, limited to charitable purposes, is deductible. Where clearly defined charitable purposes are covered in the will, the trustees or organization can choose the particular charities. An essential factor of deductibility is that the bequest must be provided by will. An authorization to survivors to make such contributions as advised by decedent are not deductible.

Foundations

A properly organized foundation does not pay federal taxes, yet can be so organized as to permit full control of its activities. Congress has set up reasonable, easy rules to follow in organizing the foundation. Congress provided against diversion of the foundations' funds. It allows them to borrow in line with banking practices. They can buy or sell assets in line with real value; all their transactions should be backed up by qualified appraisals, bids and offers.

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[33]Section 812(d).

Foundations now pay business income tax, but dividends, interest royalties, capital gains, and some rentals are received tax free. The new law says no foundation shall own or operate a business; if it does it must pay a tax on its business income. It is also taxed on long term lease-back operations. Foundations owning subsidiary business companies are taxed as regular business concerns. Foundations get full tax free credit for gifts to it on income of the investment type if its disbursements are reasonably close to its receipts. The founder and his family can deal with a foundation, but must realize that it is a fiduciary and should be treated as such. Some of the prohibitions on foundations are that they cannot lend without adequate security or at an unreasonable rate of interest. They cannot pay unreasonable compensation for personal services actually rendered. They must not make services available to the donor or his family on a preferential basis.

The new law requires honest dealing between the foundation and the donor and requires that they report annually to the government their income, expenses, accumulations, and balance sheets.

Because foundation work is socially desirable, it gets enormous tax privileges. It permits the conservation of assets and the building up of funds easier than do profit making corporations. The foundation system permits the diversion of capital to sources of the donor's own choosing. By its creation control of wealth can be maintained. Family control of business can be maintained. The tax on appreciation of stock values is saved. Large income tax deductions for the contributions at the increased value are obtained. Substantial estate taxes payable upon death are avoided. The foundation keeps income in the family. It can aid employees of the donor's business, thereby contributing to good will and productivity. It may be a method of insuring funds available for use in new business ventures, or, it may be used to avoid income from property while it is slowly being given to a foundation.[34]

Estate Tax Problems Arising Out of Divorce or Separation

Will the commuted value of payments for support of the wife after the death of the husband be deductible from the gross estate?

Will securities transferred inter vivos in trust for the wife be includible in the husband's estate? What about the portion of such payments or transfers attributable to the support of the minor children?

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[34]U.S. Treas. Reg. 105 § 81.46; Newton Trust Co. v. Commissioner, 160 F.2d 175 (1st Cir. 1947); U.S. v. Pierce, 137 F.2d 428 (8th Cir. 1943); Estate of Anna F. Kenny, 11 T.C. 857 (1948); Estate of Nellie H. Jennings, 10 T.C. 323 (1948).

Will the proceeds of insurance on the husband's life be includible in the estate?

If there is a transfer subject to estate tax, will the "marital deduction" provision apply?

These are but a few of the problems of the lawyer in advising his client.

A release of a marital right such as dower or curtesy does not support a deductible claim.[35] On the contrary, claims founded on a decree of divorce are deductible.[36] The United States Supreme Court has disposed of two troublesome issues in *Harris v. Commissioner*.[37] The Tax Court refused in a number of cases to find a taxable transfer in the divorce and separation type of property arrangement, quite apart from the question whether or not the agreement was founded upon a decree, contending that these were arms' length bargaining arrangements. This approach was disapproved by the Supreme Court. There had been some question, despite the virtual unanimity of the cases, as to whether a transfer should escape estate or gift taxes merely because "founded upon" the divorce decree. This decision by the Supreme Court laid these doubts at rest.

Local law is still complex in this respect.[38] In Nevada the contrary view is taken; that is, that if a decree adopts and approves a previous agreement the terms of the agreement can be enforced under the decree.[39]

The Bureau will permit the deduction of claims founded on a release of support rights. In the absence of allocation by the parties, the Bureau will value support rights and will disallow claims in excess thereof.[40] It is advisable that wherever possible the parties should recite an allocation in the agreement. The estate may claim its deduction without loss of the related income tax deduction.

Transfers inter vivos are not includible in the taxable estate whenever they represent a substitute for marital rights.[41] That portion of payments or transfers attributable to the support of minor children, to the extent of

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[35]Rogan v. Riggle, 128 F.2d 118 (9th Cir. 1942); Adriance v. Higgins, 113 F.2d 1013 (2d Cir. 1940); Commissioner v. Weiser, 113 F.2d 486 (10th Cir. 1940).

[36]Albert V. Moore, 10 T.C. 393 (1948); Commissioner v. Converse, 163 F.2d 131 (2d Cir. 1947), *affirming* Edmund C. Converse, 5 T.C. 1014 (1945).

[37]340 U.S. 106 (1950), *reversing* Harris v. Commissioner, 178 F.2d 861 (2d Cir. 1950).

[38]Barnard, *Incorporation by Reference of Agreements Made by the Parties in Divorce Decrees*, 21 ROCKY MT. L. REV. 420 (1950).

[39]Yoke v. Fleming, 145 F.2d 472 (4th Cir. 1944); Evanse v. Yoke, 89 F. Supp. 91 (N.D. W. Va. 1950); Albert V. Moore, *supra* note 37.

[40]F.T. 19, 1946-2 CUM. BULL. 166.

[41]Estate of Harry E. Byram, 9 T.C. 1 (1947).

their value, will support deductible claims against the estate or tax free transfer inter vivos.[42]

Proceeds of insurance are includible in the husband's estate if receivable by the estate.[43] Proceeds may be includible if the insured has paid the premiums[44] or retained incidents of ownership. The marital deduction does not apply where the transfer is subject to the estate tax.

Power of Appointment

Before October 21, 1942, appointive property was not includible in donees' estates, unless the power was general, and was exercised, and property was passed by virtue of the exercise.

A power to appoint to charities or natural persons was held not to be general, because the donee could not appoint to business corporations.[45] Even if the power was general and was exercised, there was another way out; if the appointees were the same persons who would have taken in default of appointment, they could elect to be "takers in default of appointment" instead of "appointees," and the appointive property would not be deemed to have passed to them by reason of the appointment.[46]

The Powers of Appointment Act of 1951[47] takes effect as if its provisions had been enacted in 1942 and as if the 1942 legislation had not been enacted. Its estate tax provisions apply to estates of all who died after October 21, 1942, and its gift tax provisions apply to all gifts made after January 1, 1943. The 1951 law treats separately powers created before October 21, 1942, and those created after that date.

As to estate tax, a power is considered created on or before October 21, 1942, if it was granted by a will of a testator who died on or before October 21, 1942; or if it was granted by a will signed on or before October 21, 1942, and the donor of the power died before July 1, 1949, without having republished such will by codicil or otherwise after October 21, 1942; or if it was granted by an inter vivos instrument executed on or before October 21, 1942.

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[42]Edmund C. Converse, *supra* note 37, *affirmed without mention of the point,* Commissioner v. Converse, 165 F.2d 132 (2d Cir. 1947) (gift tax); Helvering v. U.S. Trust Co., 111 F.2d 576 (2d Cir. 1940), *remanding* Estate of Geo. Tuttle Brokaw, 39 B.T.A. 783 (1939), *cert. denied,* 311 U.S. 678 (1940).

[43]Blumenthal v. Commissioner, 183 F.2d 15 (3d Cir. 1950); Halsey W. Taylor, 16 T.C. 376 (1951) Nonacq., 1951-2 Cum. Bull. 6; Lemuel A. Carmichael, 14 T.C. 1356 (1950) Acq., 1950-2 Cum. Bull. 1; Estate of Silas B. Mason, 43 B.T.A. 813 (1941) Nonacq., 1941 Cum. Bull. 17.

[44]Estate of Judson C. Welliver, 8 T.C. 165 (1945).

[45]Christine S. Hendrick, 34 B.T.A. 1040 (1936); Waldemar R. Helmholz, 28 B.T.A. 165 (1933), *aff'd sub nom.* Helvering v. Helmholz, 296 U.S. 93 (1935).

[46]Rogers v. Commissioner, 320 U.S. 410 (1943); Helvering v. Grinnell, 294 U.S. 153 (1935).

[47]Pub. L. No. 58, 82d Cong., 1st Sess. (1951).

Refunds of taxes paid under the 1942 Act can be obtained only if the statute of limitations for refunds has not run.

If the power was created on or before October 21, 1942, the appointive property is includible in the donee's gross estate for estate tax only if the power is *exercised* and only if it is general, and exercisable by the donee alone and not in conjunction with another person. But if the general power is partially released before November 1, 1951, so that it is no longer a general power, or within such later time as is granted to donees who are under disability or in military service, the subsequent exercise of such power will not be considered the exercise of a general power.

If the power was created after October 21, 1942, the appointive property is includible in the donee's gross estate for estate tax whether he exercises or refrains from exercising it; or, if he has exercised or released the power by an inter vivos disposal, such property is includible in the donee's estate as a transfer under Section 811(c) or 811(d) of the Internal Revenue Code.

All joint powers created on or before October 21, 1942, are excluded from the definition of general powers. Those created after October 21, 1942, are included in the definition of general powers to some extent.

If the decedent has power to invade the principal, such power is not a general power of appointment, whether created before or after October 21, 1942, if such power is limited by "an ascertainable standard relating to the health, education, support, or maintenance of the decedent."

Exercising a power to create another power invalid under the 1942 Act is changed by the 1951 Act, which provides that if any power created after October 21, 1942, is exercised by creating another power, the appointive property is includible in the donee's gross estate if under the applicable law the new power can be validly exercised so as to postpone the vesting of any estate or interest in such proprety, or suspend the absolute ownership or power of alienation of such property, for a period ascertainable without regard to the date of the creation of the first power.

QUANTITATIVE EVALUATION OF REPARATION SYSTEMS

*Alfred F. Conard**

The traditional way of evaluating a reparation system is to look at what the system punishes and what it rewards. Is a man punished for being negligent? Is he rewarded for being free of negligence? Or is he punished for being an employer whose employee is hurt? And is the employee compensated simply because he was hurt, without regard to the distribution of fault?

In an ethical evaluation we take our choice among these alternatives on the basis of what seems to us the conduct which a man should follow. If every employer should take care of his employees, we decree compensation. If only a negligent employer should, we adhere to the common law of torts.

I like the ethical system of evaluation. I can do it from my swivel chair without the necessity of having any additional facts before me. I can entertain my students with it. I can use it as material for arguments in court.

A second system of evaluation I would call welfare evaluation. For this purpose we look to see who is to pay and who is receiving the payment, and then we look to see who is better able to spare the dollars, or who will enjoy those dollars the most. If claimants are poorer than employers, let us increase the measure of payment to claimants. If pedestrians are more needy than automobilists, let us increase the measure of recovery of pedestrians.

This system of evaluation is a little harder to use than the ethical because it requires a little bit of fact. But it is the type of fact which can usually be drawn from common knowledge without leaving the swivel chair. For example, we know that employers value their dollars less than employees value them. This follows from Josiah Wedgegood's theory of diminishing utility of money, which we are not disposed to challenge, and we know perhaps that pedestrians are poor people and automobilists rich people and so on.

A third system of evaluating a reparation system is what I would call the quantitative method. In this system we ask questions which relate to the entire operation of the system. If we have a rule that the negligent defendant pays the innocent plaintiff, we will ask who gets money out of this rule, how much of it goes to injured people, how much of it goes to lawyers, and how much of it goes to insurance companies.

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*Professor of Law, University of Illinois.

Among the claimants themselves, we will ask some questions relative to their economic loss. Is more paid to the small claimants or to the large claimants? To the litigious claimants or to the agreeable claimants? To the honest claimants or the exaggerating and fraudlent claimants?

Among the lawyers, we will perhaps ask some questions about which lawyers receive the benefits? Are they ambulance chasers? Are they violators of the canons of ethics? Are they the best qualified men to do their jobs? Or does the system lead to the channelling of business to the least desirable practicioners? I do not mean to ask this question in a way which forecloses the answer. In the pious desire of the formulators of the canons of ethics to restrict practice to the lawyer who is personally selected by the claimant, I wonder if they have asked themselves what kind of a laywer is a personal friend and acquintance of a ditchdigger, coal handler, or pullman porter?

In a quantitative evaluation we will also ask who pays, how much of this cost comes from negligent persons, how much comes from persons whose basis of liability is solely that they are supposedly wealthier? How much of it is passed on to consumers? And then we might have an interesting question which eventually becomes a welfare one: are the consumers of bread more able to pay than the men who deliver bread, or the pedistrians who are struck by the bread truck? The big difficulty with the quantitative evaluation system is that the information on it is very hard to get. Hardly any of it can be described from the swivel chair, and it is very expensive when we go out to get it.

I do not recommend quantitative evaluation as a substitute for ethical evaluation or welfare evaluation. I think there is no substitute for those systems. But I think it is a valuable addition and supplement to those systems. For example, under the ethical system, when we decide that an employer should take care of the injuries of his employees, are we prepared to say also that he should bear an equivalent expense in carrying insurance, in compensating his own adjusters and lawyers and in compensating the plaintiff's? From the welfare point of view let us concede that it is a fine thing to transfer money from employers and consumers to workmen, but for the $300,000,000 a year which we spend in this way are we distributing it in the best possible way? Is the greatest welfare being created by the distribution of this vast sum of money among the claimants, lawyers, adjusters, insurance salesmen, insurance executives, insurance investors, as it is now distributed? Or can we devise some other system of distribution which furthers social welfare even more?

Although I have said that the quantitative system of evaluation requires a good deal of information, I do not think we need leave our swivel

chair before we give it any thought at all. I am inclined to think that we have not even completed the swivel chair portion of our investigation until we have given some thought to quantitative factors. If, for example, you favor a rule making every automobile driver responsible for the medical expenses of every man injured by his driving, how much of the proceeds of this rule do you think are going toward paying insurers, adjusters, lawyers, jurors and how much to injured claimants? Until you have at least reached an opinion on that point, I do not see how you can have an opinion for or against the rule.

Now what do we know about the facts which we will want to consider for a quantitative evaluation of reparation systems?

First, there is the folklore. All liability systems based upon the common law are horribly expensive. Their proceeds are eaten up in the endless litigation of lawyers. This impression was first put out by the New York Commission "to consider the question of employers' liability," which published its famous first report in 1910.[1] This report has become justly famous and is quoted extensively in nearly every book which deals with labor legislation. The New York Commission found that the common law system was wasteful.

In 1932 a "Committee to Study Compensation for Automobile Accidents" again looked at the common law system of liability.[2] They concluded again that it is a wasteful, expensive system. And in 1947 the railroad retirement board reported on an exhaustive study of compensation for railroad injuries,[3] with the conclusion again that the common law system, as modified by the Federal Employers' Liability Act, was an indefensibly costly arrangement.

Each of these study groups concluded that costs of liability enforcement should be reduced by the adoption of a compensation system. None of them observed the costs of the compensation system. The New York Commission of 1910, of course, could not. There was no compensation system, at least not in this country. The automobile accident committee thought it was unnecessary to look into the matter. The Railroad Retirement Board included in its survey certain accidents compensated under workmen's compensation acts. It found employers incurring large adjustment and legal expenses, but it did not think it necessary to distinguish between those occasioned in employers' liability and those in workmen's

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[1]New York Commission to Inquire Into the Question of Employers' Liability, First Report (1910).

[2]Committee to Study Compensation for Automobile Accidents, Report (1932).

[3]U.S. Railroad Retirement Board, Work Injuries in the Railroad Industry 1938-1940 (1947).

compensation. It assumed that costs were negligible in a compensation system.

Now for the data. What the New York Commission showed about employers' liability in 1910 was that when employers buy liability insurance, 37 cents out of every dollar went to pay employees and 63 per cent went to the expenses of insurance, adjustment, and litigation. Restating this in percentage of claims paid, an amount equal to 175 per cent of the claims was spent for costs of administration in addition to the claims themselves. And this was without counting claimants' attorneys' fees, which the commission estimated at 23 per cent of the claims paid.

Putting both these expense figures together, the New York Commission showed that for every dollar paid to claimants, $1.98 is paid to somebody else. They concluded that employers' liability was a bad system.

The most striking feature about the New York Commission report, and about the wide-spread publicity it has received, is the complete ignoring of some other figures which appeared in the same report, figures which related to the expenses of employers who did not take insurance. A considerable survey was made of such employers, showing that for them the ratio of claims payments was not 37 per cent, but 90 per cent of the total employers' costs. Expenses, therefore, were only 11 per cent of claims paid. Even if we repeat the assumption made before with respect to claimants' attorneys' fees, the total expense of administration of employers' liability without insurance would have been only 34 cents for every dollar paid to employees. From our present vantage point, we may say that that was not a bad record. However, neither the New York Commission nor the labor economists who have so extensively quoted the report gave any attention to this phase of its observations.

In 1932, when the automobile compensation study was released, it indicated a loss ratio of 54 per cent. Converted to our terms, this meant that for every dollar of claims paid, 85 cents was paid for insurance and the costs of handling claims. This estimate was made without any consideration of claimants' legal expenses.

In 1947 the Railroad Retirement Board studied claims in the railroad industry, and found that administrative expenses, both plaintiffs' and defendants', amounted to 26 per cent of claims paid. This was also considered excessive, and the basis for a demand for a switch to a compensation system.

Meanwhile, no observations at all had been made on workmen's compensation. So far as I know, the first observation of this type was made in the Illinois study, published just this year.[4] The Illinois study showed

a losses-to-premimum ratio of 57 per cent for insured employers, meaning that for every dollar paid to employees' claims, 76 cents was spent by defendants for insurance and for legal protection. When the claimants' expenses are added, it is found that the total expense of operation is nearly 100 per cent of claims paid and this, in fact, is considerably more than 100 per cent of the net benefit which claimants received. The same survey indicated an expense under the Federal Employers' Liability Act, which is administered without insurance, of only 23 per cent of claims paid. The result of the Illinois study was to show that the high expense ratio which had been made the basis of a shift to a compensation system was in no way a feature of a *common law* system but was a feature of an *insured* system. Insurance is, in fact, no more necessary nor less necessary for a compensation system than for an employers' liability.

Where does this line of inquiry lead us? For the most part I should say that it leads nowhere. This is more important than you might think. There are people who want us to adopt a compensation system for those few portions of employers' liability which are still governed by substantially common law principles. One of the reasons they tell us we should do this is because of the immense waste of the employers' liability system. I think that is an argument which has been exploded.

There are also people who want us to change from a common law system of liability for automobile accidents to a compensation system. One of the reasons they urge is the horrible expense of our present system. I think this too is a fallacy.

We may want to go to a compensation system. I am not an opponent of such a system. But if we do, let us not go in pursuit of a mirage.

On the other hand, I think there are things that we can do with our present reparation systems. We can improve them. We can reduce the unproductive expense which they comprise. I cannot tell you how these changes are to be made. To my mind, investigation of this subject has only begun. Since the annual bill for reparation is in the hundreds of millions each year, the investigation is well worth whatever it is likely to cost us.

I can only suggest a few things which investigation might point to as possible avenues of improvement. First, we need to know more about the role of insurance. It is expensive. Is it necessary? It is rather conclusively shown that large employers, both railroad and industrial, are

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[4]Conard & Mehr, Costs of Administering Reparation for Work Injuries in Illinois (1952).

today saving large sums of money by self-insuring. Under some laws, self-insurance is forbidden. It seems obvious that these should be corrected. We should investigate further the role which self-insurance can properly play without jeopardizing the compensation of workmen.

The next thing which quantitative evaluation will help us to understand is the role of lawyers in the reparation of injuries. The facts now on hand indicate that lawyers play a much less active part in Federal Employers' Liability than they do in workmen's compensation. How does that work out? Does it result in gross underpayment? And what kind of lawyers are hired ? Obviously the hiring of lawyers by claimants is today on an unsatisfactory basis. We condemn the ambulance chasing, but what alternative do we offer?

Our quantitative studies will lead us also to understand better the role of administration by courts and boards in the reparation of accidents. Workmen's compensation acts are apparently conceived in the belief that if every award passes the scrutiny of an investigating commission, claimants will no longer need lawyers. Reparation will be made in the proper amount at minimum expense. Such observations as we have indicate that the practice is exactly the opposite. The more the boards look into payments, the more the claimants obtain legal representation. This needs further observation.

Finally, we need to explore the possibilities of reducing the subjects of litigation in reparation cases. Most of us, at least in the law schools, have been impressed by the difficult jurisdictional questions which arise in workmen's compensation cases. During the Thirties we complained of the immense waste of money in litigating, whether a case came under a state workmen's compensation law or the Federal Employers' Liability law. The railroad retirement study and the Illinois study, in my mind, show that we were on the wrong track. Undoubtedly such jurisdictional arguments are fruitless and should be reduced, but they are not the places where money is being spent in large quantities. It is being spent on questions which inhere in every case, the questions of physical injury. No substantial improvement in the efficiency of handling injury cases will be effected until we find some way to terminate or reduce the battle of the expert witnesses.

In conclusion I suggest that quantitative evaluation will help us to make decisions on changes in our laws of reparation, whether based on a common law pattern, or on the workmen's compensation template. It will help us to get laws which effectuate our objectives, and will save us from battles which are heroic in the law reviews, but which have little impact on the welfare of human beings.

SPECIAL INDUSTRY PROBLEMS—A TAX TRILOGY†

The Cattleman—Cattle Breeding Breeds Capital Gains

*Felix T. Terry**

Prior to the year 1942 there was no attempt by cattlemen to treat the sale of breeding cattle under the capital assets provisions of the Internal Revenue Code, for the reason that depreciable assets were excluded by definition from the category of capital assets. In 1942, however, Congress added Code Section 117(j), which provides for capital gains treatment of a net gain from sales of "property used in the trade or business" of a taxpayer and held for more than six months.

It was not until 1944, two years after Section 117(j) was added to the Code, that the Commissioner of Internal Revenue issued a ruling regarding the treatment of sales of cattle. The ruling[1] recognized that a breeding herd owned by a livestock raiser is "property used in the trade or buiness," within the meaning of Section 117(j), provided that the animals are held for more than six months. This ruling stated that the sale of animals culled from the breeding herd as feeder or slaughter animals was not to be treated as the sale of capital assets. An amplification[2] issued in 1945 which limited capital gains treatment to unusual or abnormal sales which either reduced the size of the normal breeding herd or resulted in a change of breed, but excluded routine or customary sales of culled animals.

In 1949, in the first major judicial departure from the Bureau's interpretation, the United States Court of Appeals, in *Albright v. United States,*[3] held that animals used for breeding purposes, whether or not sold as culls in the ordinary course of business, constituted property used in a trade or business within the meaning of section 117(j). The case involved the sale of cows culled from the dairy herd and of breeding hogs. The Circuit Court of Appeals concluded that the interpretations of the Commissioner were contrary to the intent of Congress expressed in Section 117(j), which was intended as a relief measure applicable alike to all taxpayers within its provisions. The court pointed out that in order for the taxpayer to come within the provisions of Section 117(j), the burden was upon him to show that the animals sold were (1) used in his trade or business; (2) subject to the allowance for depreciation; (3) held for

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*CPA, Frazer & Torbet, Houston, Texas.

[1]I.T. 3666, 1944 Cum. Bull. 270.

[2]I.T. 3712, 1945 Cum. Bull. 176, *amplifying* I.T. 3666, 1944 Cum. Bull. 270.

[3]173 F.2d 339 (8th Cir. 1949).

more than six months; (4) not property of a kind includible in the inventory of the taxpayer if on hand at the close of the taxable year; and (5) not held by the taxpayer *primarily* for sale to customers in the ordinary course of his trade or business.

Following the thought reflected in the *Albright* opinion, the Tax Court applied the view to comparable sales from ranch herds used for the breeding of beef cattle. In *Fawn Lake Ranch Co.*[4] the gains were from the sale of surplus cattle from the taxpayer's breeding herd, which was kept separate from the other cattle held for sale to customers in the regular course of business. The surplus cattle were sold in order to maintain the breeding herd at its required number. In *Franklin Flato*[5] the taxpayer sold his ranch and cattle, consisting of his breeding herd and cattle raised primarily for beef. If a cow was over one year old when sold, the taxpayer reported it in the sale of breeding cattle. The court held that those cows sold were the breeding stock, the sale of which was analogous to the liquidation of a business. The Tax Court also followed the *Albright* decision in cases involving the sale of dairy animals.[6] In *Leonard C. Kline*[7] the taxpayer purchased cows which had been bred before purchase or were bred on the taxpayer's ranch soon after purchase, were held over for a crop of spring calves, and then were sold to the beef market. The court held that the taxpayer's predominant purpose was feeding and marketing the cattle for beef; therefore, the gain on their sale was taxable in full as ordinary income.

Notwithstanding the *Albright* decision, the Treasury Department continued to adhere to its position initiated in the 1944 and 1945 rulings, pending possible contrary decisions in other circuit courts which might result in a conclusive decision by the Supreme Court. The revenue bill as passed by the Senate in 1950 contained a provision intended to clarify this situation, but this was rejected in joint conference. The conference committee, however, expressed hope that the Treasury would follow the *Albright* decision.

The United States District Courts generally followed the *Albright* decision, except for two cases in the District Court for the Northern District of Texas. In both cases the court found that the cows had not been held primarily for breeding purposes, since their sale did not reduce the

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[4]12 T.C. 1139 (1949) Nonacq., 1949-2 CUM. BULL. 4.
[5]14 T.C. 1241 (1950) Nonacq. 1950-2 CUM. BULL. 5, *affirmed*, Flato v. Commissioner, 195 F.2d 580 (5th Cir. 1952).
[6]Isaac Emerison, 12 T.C. 875 (1949); Charles O. Fritz, 19 P-H T.C. MEM. DEC. ¶ 50,030 (1950).
[7]15 T.C. 998 (1950).

size of the breeding herd.[8] In *Bennett v. United States*[9] the District Court for the Western District of Texas held that Section 117(j) applied to the sales of culled breeding cattle (cows and bulls) which had become unsuitable for breeding purposes. The District Court for the District of South Dakota likewise allowed capital gains treatment of the gain from the sales of culled breeding cattle.[10]

The *Finch, Birbeck* and *Bennett* cases[11] on appeal were consolidated by the United States Court of Appeals, Fifth Circuit. The *Finch* and *Birbeck* decisions were both reversed and the *Bennett* decision was affirmed by the court; thus, the taxpayers prevailed in all three cases.[12] The Circuit Court of Appeals held on the authority of the *Albright, Emerson,*[13] and *Fawn Lake Ranch* cases that where taxpayers were engaged in the business of breeding cattle to sell the calves, gains from the sale of cows and bulls held for more than six months were subject to the benefits of Code Section 117(j).

The *Bennett* decision was followed by the United States District Court for the Northern District of California in a case involving similar facts.[14] The United States District Court for Nebraska in *Miller v. United States*[15] was concerned with the sales of Hereford cows, bulls, and heifers, all of which were part of the breeding herd. The bulls had been used as sires for three or four years and the breeding cows were over two years old when sold. The heifers, eighteen or ninteen months old when sold, had been made subject to "dock" for pregnancy after initial exposure to pregnancy. All of the animals were removed from the breeding herd by a process of selection or culling. The court felt constrained to follow the *Albright* and *Bennett* decisions. The Tax Court in two decisions[16] involving facts similar to those in the *Albright* case, followed the previous judicial authority.

In *Walter S. Fox,*[17] the first decision involving registered cattle and capital gains, the Tax Court was concerned with the problem of which of the cattle raised and sold by the taxpayers were part of their breeding herd. The taxpayers maintained a producing herd of Aberdeen Angus

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[8]Finch v. Arnold, 50-2 U.S.T.C. ¶ 9401; Birbeck v. Thomas, 52-2 U.S.T.C. ¶ 9400.

[9]89 Fed. Supp. 106 (W.D. Tex. 1950).

[10]Lewis v. U.S., 51-1 U.S.T.C. ¶ 9148.

[11]See notes 8 and 9 *supra.*

[12]U.S. v. Bennett, 186 F.2d 407 (5th Cir. 1951).

[13]Isaac Emerson, *supra* note 6.

[14]Mitchell v. U.S. 96 Fed. Supp. 473 (N.D. Cal. 1951).

[15]98 Fed. Supp. 948 (D. Neb. 1951).

[16]Elmer Becker, 20 P-H 1951 TC MEM. DEC. ¶ 51,162 (1951); Arie Brouwer, 20 P-H TC MEM. DEC. ¶ 50,020 (1951).

[17]16 T.C. 854 (1951).

cattle, the offspring of which they customarily sold to other breeders. The Tax Court concluded that the heifers raised, registered, and sold by the taxpayers before they dropped calves should not be regarded as a part of the breeding herd. Since there was little evidence as to the exact number of heifers in that category, the Tax Court made an approximation. The court reasoned that since the average age at which heifers dropped a calf was twenty-six months, those females sold when twenty-six months old or over were part of the breeding herd. Of the bulls sold by the taxpayer, only those thirty-four months old or older were accorded treatment as part of the breeding herd, since the court reasoned that, "until a bull reached an age of 32 to 37 months, it could not be satisfactorily determined that it possessed the necessary breeding qualities for such a herd," as taxpayers maintained. The taxpayers contended that as soon as any animal raised by them was registered (usually at six months) it became a part of their breeding herd. The Tax Court, naturally, denied their contention with the comment that the mere act of registration did not establish an animal as a member of the breeding herd. Many cattlemen and tax authorities voiced the opinion that the case had not been properly presented, as the taxpayers failed to give the court any history of the animals for the determination of their inclusion in the breeding herd. The decision obviously failed to give a satisfactory guide.

The question of which cattle were part of the breeding herd was also before the Tax Court in *A. Harold Schmidt*[18] where the taxpayers were likewise engaged in the business of raising purebred cattle. At least 95 per cent of taxpayers' sales were to other breeders. The court concluded that only the animals (cows and bulls) over twenty-four months of age when sold were part of the breeding herd. The court considered the fact that the heifers were bred for the first time at ages between eighteen and twenty-four months. In a subsequent case, *James M. McDonald,*[19] the Tax Court held that the *Fox* case was determinative with respect to the cattle raised by the taxpayer and sold, but concluded, as in the *Schmidt* decision, that the cows over twenty-four months of age when sold were part of the breeding herd. The court considered that the gestation period was nine months and that the taxpayer usually bred the heifers when they were fourteen months old. Thus it is observed that in the *Fox, Schmidt,* and *McDonald* cases the Tax Court used three different formulas for determining the age at which cattle were to be included in the breeding herd.

The United States District Court of Nebraska in *Laflin v. United States*[20] stated that the court had not been moved, as was the Tax Court

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[18]20 P-H 1951 TC MEM. DEC. ¶ 51,160 (1951).
[19]17 T.C. 210 (1951).
[20]100 Fed. Supp. 353 (D. Neb. 1951).

in the *Fox* case, "to prescription of inflexible and perhaps arbitrary ages as the measure either of inclusion in the taxpayer's breeding herd or of the primary purpose of his holding" the animals. The taxpayer was engaged in the breeding, raising, and sale of cattle. The court listed the sales in two groups. "Group I" contained cows and bulls ranging in age from three months to one year and ten months; and "group II" contained cows from two years and five months to nine years of age. From this grouping, the court found that the animals listed in "group I" were held primarily for sale to customers in the ordinary course of business, while those in "group II" were held in the breeding herd.

To align its view with that of the *Albright* and *Bennett* decisions, the Bureau of Internal Revenue finally issued a ruling[21] stating that capital gains without treatment provided in Section 117(j) would be applied to sales of culls, provided the animals had been used for substantially their full period of usefulness. This exception resulted in new uncertainties, as many examining agents interpreted this ruling to mean that only animals which were about ready to die of old age would qualify for the capital gains treatment. The court in *Laflin v. United States*[22] refused to "accept as a realistically valid test of a cow's actual use or primary holding for breeding purposes, the requirement that she be so used for substantially her full period of usefulness."

In an attempt to clarify its intention, Congress amended Section 117(j) in October, 1951, to provide that profits from the sale of "livestock, regardless of age, held by the taxpayer for breeding purposes and held by him for twelve months or more," should be eligible for capital gains treatment. The amendment applies to taxable years beginning after December 31, 1941, except that the provision for extension of the holding period from six to twelve months is applicable only after December 31, 1950.

The Bureau has issued a ruling[23] to conform its position to the Code amendment. This ruling means that the Bureau now recognizes that livestock, regardless of age, held by the taxpayer for breeding purposes, and held by him for twelve months or more from the date of acquisition constitutes "property used in trade or business." Under appropriate provisions of Code Section 117(j)(2), the gains and losses from sales are subject to capital gains treatment.

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[21]MEM. 6660, 1951-2 CUM. BULL. 60, *revoking* I.T. 3666, 1944 CUM. BULL. 270; I.T. 3712, 1945 CUM. BULL. 176.

[22]See note 20 *supra.*

[23]MEM. 6776 (March 1952). MEM. 6660, *supra* note 21, is revoked, but the revocation does not reinstate I.T. 3666 or I.T. 3712, *supra* note 21.

Proposed amendments to the regulations to conform to the 1951 amendment to the Internal Revenue Code were published in the *Federal Register on* May 16, 1952.[24] The pertinent provisions relating to breeding cattle are as follows:

> ". . . The determination whether or not livestock is held by the taxpayer for a draft, breeding, or dairy purpose depends upon all of the facts and circumstances in each particular case. The purpost for which the animal is held in ordinarily shown by the taxpayer's actual use of the animal. However, a draft, breeding, or dairy purpose may be present in a case where the animal is disposed of within a reasonable time after its intended use for such purpose is prevented by accident, diseace, or other circumstances. An animal held for ultimate sale to customers in the ordinary course of taxpayer's trade or business may, depending upon the circumstances, be considered held for a draft, breeding, or dairy purpose. An animal is not held by the taxpayer for a draft, breeding, or dairy purpose merely because it is suitable for such purpose or because it is held by the taxpayer for sale to other persons for use by them for such purposes, Furthermore, an animal held by the taxpayer for other purpose is not considered to be held for a draft, breeding, or dairy purpose merely because of a negligible use of the animal for such purpose as an ordinary or necessary incident to the purpose for which the animal is held."

The proposed amendment present the following examples to illustrate the above principles:

> "Example 1. An animal intended by the taxpayer for use by him for breeding purposes is dicovered to be sterile, and is disposed of within a reasonable time thereafter. This animal was held for breeding purpose.
>
> "Example 2. The taxpayer retires from the breeding or dairy business and sells his entire herd, including young animals which would have been used by him for breeding or dairy purposes, if he had remained in business. These young animals were held for breeding or dairy purposes . . .
>
> "Example 5. The taxpayer is in the business of raising registered cattle for sale to others for use by them as breeding cattle. It is the business practice for the cattle to be bred, prior to sale, in order to establish their fitness for sale as registered breeding cattle. In such case, those cattle used by the taxpayer to produce

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[24] *Proposed Rules Making, Department of the Treasury,* 17 FED. REG. 4494: "In order to conform Regulations 111 . . . to section 324 (relating to sales of livestock) of the Revenue Act of 1951, approved October 20, 1951, such regulations are hereby [proposed to be] amended as follows. . . ."

> calves which are added to the taxpayer's herd are considered to be held for breeding purposes; the taxpayer's use of the other cattle for breeding purposes is an ordinary or necessary incident to his holding such other cattle for the purpose of selling them as registered breeding cattle, and such use does not demonstrate that the taxpayer is holding the cattle for breeding purpose.
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> "Example 6. A taxpayer, engaged in the business of buying cattle and fattening them for slaughter, purchased cows with calf. The calves were born while the cows were held by the taxpayer. These cows were not held for breeding purposes."

In a recent case[25] the United States District Court for the Southern District of California was concerned with the sale of two-year-old heifers that were at no time pastured with bulls. The policy of the taxpayer had been to place heifers with bulls before the heifers were two years of age, but in the taxable year involved (1944), the decision was made to sell about half of the two-year-old heifers raised by the taxpayer. The court concluded from the facts that the heifers sold were held for breeding purposes within the meaning of Section 117(j).

The United States Court of Appeals, Fourth Circuit, on July 31, 1952, in affirming the decision of the Tax Court in *Walter S. Fox,* pointed out that the amendment to Section 117(j) in 1951 did nothing to change the requirements as to the *purpose* for which property must be held in testing whether the proceeds from its sale constitutes capital gain or ordinary gain.[26] The taxpayer stressed the fact that the amendment refers to livestock, *regardless of age,* and from this he argued that a breeding herd may be made up of animals none of which had as yet been bred, or which may even have been too young for breeding. The court answered that this argument ignores the point of the matter; that is, that the age of the animals is not the important thing, but the *purpose* for which they are held. The Circuit Court's view of the Tax Court's decision, as voiced in the following excerpt from its opinion, is interesting to note:

> "The Tax Court allowed the taxpayer to treat as a part of the breeding herd all animals held by the taxpayers until the age when their ability to produce calves was proven; even though the animals might have been sold the very next day and although petitioners had never intended to include them in their producing herd. In so doing we think that the court gave these petitioners even more than was required by the facts shown."

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[25]O'Neill v. U.S., 52-2 U.S.T.C. ¶ 9462 (1952).

[26]Fox v. Commissioner, 198 F.2d 719 (1952), *affirming* Walter S. Fox, *supra* note 17.

In August of 1952 the Tax Court was concerned with the sale of cattle from both the taxpayer's stock in trade and his breeding herd.[26] The taxpayer was engaged exclusively in the production of registered Hereford cattle, primarily for sale to others as breeding stock. In the first sale in question, the taxpaper sold twenty-seven registered heifers from thirteen to seventeen months of age, one bull twenty-two months of age, and sixteen registered heifers from nineteen to thirty months of age. The court pointed out that while the taxpayer's practice was to separate the best heifers, when they were twelve month old, for his breeding herd, the heifers that were sold had not been so separated. The court concluded that those heifers were taxpayer's stock in trade. The bull was likewise considered, since he had never been placed in the breeding herd. In the second sale, the taxpayer sold forty-nine two-year-old heifers in an advanced state of pregnancy from his breeding herd, which was kept completely apart from the animals held for sale. From these facts, the court concluded that those heifers were held in the breeding herd. As for the third sale in question, the court determined that it was impossible to ascertain from the evidence which of the cows were part of the breeding herd and which were part of the regular stock in trade; therefore the court treated them as part of the latter.

These three latest cases stress the view as expressed in the proposed amendments to the Regulations that the *purpose* for which the cattle are held is determinative of capital gains treatment under Code Section 117(j). The purpose for which the cattle are held is a fact question, the answer to which depends upon all of the facts and circumstances of each case. The taxpayer has the burden of proof of his purpose; he must present evidence from which the court can ascertain those animals used for breeding purposes. With this thought in mind, taxpayers who own breeding herds should keep accurate records on all cattle suitable for breeding purposes, setting forth their registration numbers, if any, ages, production records, and any other pertinent data for identification. In addition to keeping such identification records, the cattle raiser would be wise to separate his breeding herd, including all of the young animals he intends to use for breeding purposes, from any cattle he holds out for sale.

The Farmer—Control of Income and Expenses

*Richard W. Beebe**

Farm net income varies more than most other types of business income. This variation is due to one factor over which the individual farmer has no control—the weather. A drought, such as has occurred in

*Attorney at Law and CPA, Kindig & Beebe, Sioux City, Iowa.

parts of the South and parts of the West in 1952, or a flood, such as has occurred in the Missouri Valley, or an untimely freeze or frost may turn their prospective high net income into a loss. The individual farmer, therefore, may have a high net income one year and a low net income or a loss the following year. Theoretically, the gains and losses in the successive years can be evened up through the use of the net-operating-loss provisions of the law. These provisions, however, do not assist the farmer who has a $20,000 net income one year and a $500 net income the previous or following year. In addition to this situation, most farmers are not interested in subjecting themselves to the bother of an audit, no matter how honest and accurate their returns may have been. The problem of the farmer, therefore, is to find a solution so that his income from year to year will vary no more than necessary.

The accounting method in use by the particular farmer, as well as business practices, need for money, market fluctuations, and other matters, determines the nature and the extent to which it is possible to control his income in the various years.

Expenditures

Of the three accounting methods available to the farmer, the cash method of accounting offers the greatest opportunity for flexibility. Also, it makes for the greatest hazards if not properly used. Assume we have a livestock feeder who has achieved a considerable net income for the eleven-month period up to December 1. He knows he will be compelled to buy feed within the next month or two. He is in the position of being able to buy the feed this year and deduct it as an expense this year, or he can wait until the following year to purchase the grain or feed and deduct it in the latter year. Perhaps a farmer who lives in an area which has suffered from drouth this year has had practically no taxable income but is feeding livestock which he expects to sell the following year. Strictly from a tax point of view, if on the cash basis, it would be foolish for him to buy any more feed this year than he absolutely needs. He will benefit more by deferring purchase of feed utnil the following year, which will be the year in which he requires expenses to offset the income realized through the sale of his livestock.

The foregoing examples illustrate the opportunities available in controlling farm income while on the cash basis by expending monies for expense at the proper time. Generally, the expense is deductible when the cash is expended, regardless of the fact that the purchased property is not used until a later year. In *D. K. McColl*[1] it was held that the amounts

[1] 10 P-H B.T.A. Mem. Dec. ¶ 41,050 (1941).

paid in 1935 for fertilizer to be used in 1936 was deductible in 1935; also, a letter dated December 16, 1943, signed by T. Mooney, Deputy Commissioner, stated that the cost of cattle feed is deductible only in the year purchased and paid for and not in the year the cattle are sold, nor in proportionate amounts over the period of consumption.[2]

There are certain limitations to be kept in mind, however. In the case of lime spread on land which will have usefulness over several years, the cost thereof constitutes an exhaustible capital expenditure which should be amortized over the period of usefulness.[3] Further along this line, insurance paid for in advance for a period of three years should be pro-rated over the three-year period, even if on the cash basis.[4]

Income

Regulation 111, Section 29.22(a)-7, by providing for reporting income when cash or other property is received, allows latitude on the part of the taxpayer to the extent that the taxpayer can control the year of sale and, consequently, the year of receipt of livestock, crops, and other items. Of course, problems of constructive receipt apply here equally as much as in other fields of taxation. In *J. D. Amend*,[5] it was held that constructive receipt does not apply where a taxpayer follows the regular practice of contracting to sell wheat in one year for delivery and payment in the following January and that the income is not taxable until the following January. The court in this case said:

> "Our conclusion, as already stated, is that the contract was a bona fide arms-length transaction and petitioner did not have the right to demand the money for his wheat until in January of the year following its sale. This being true, we do not think the doctrine of constructive receipt applies."

Regulation 111, Section 29.22(a)-7, however, does not allow a farmer to select the year in which he wishes to place his income. As an example, assume a farmer has had a poor year up to December 15, 1952 and he has incurred a lot of expense but has on hand grain and livestock. He may wish to sell some of the grain or livestock before the end of the year to offset some of the expense and thus avoid finding himself in a high bracket in 1953. The sale of course, should be bona fide and complete with receipt of proceeds in 1952. Needless to say, it is not difficult to achieve the honor of being in a high bracket, if the taxpayer is not

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[2]P-H Fed. Tax Serv. ¶ 66,149 (1944).
[3]I.T. 3843, 1947-1 Cum. Bull. 12 (1947).
[4]G.C.M. ¶ 13,148, XIII-1 Cum. Bull. 67 (1934).
[5]13 T.C. 178 (1949).

cognizant of the tax situation and sells two or more grain crops in one year.

Commodity Credit Corporation Loans

Regulation 111, Section 29.123-1, provides as follows:

> "A taxpayer who receives a loan from the Commodity Credit Corporation may, at his election, include the amount of such loan in his gross income for the taxable year in which the loan is received. If the taxpayer makes such an election. . . ."

One important aspect of this regulation is that, once an election is made, the farmer cannot change his method of reporting unless he secures the permission of the Commissioner. An interesting case which developed under this situation occurred in *W. A. Sloper.*[6] In that case it was held that where a partnership complied with regulations in making its election under Code Section 123(a) so that the amount received as a Commodity Credit Corporation loan could be included in income when received, and the loan was approved and check was mailed to the partnership on December 30, 1938, but not received by the partnership's agent until January 3, 1939, the proceeds of the loan were not actually or constructively received by the partnership on a cash basis until 1939, and the taxpayer, a member of the partnership, should have reported his share of such loan for 1939.

Regulation 111, Section 29.123-2, also provides that the taxpayer realizes no additional income at the time the Commodity Credit Corporation sells or disposes of the commodity pledged unless the taxpayer receives an additional amount in addition to that advanced to him as a loan. The regulation also provides that the taxpayer shall have no deductible loss on account of any deficiency realized by the Commodity Credit Corporation, if the taxpayer was relieved from liability for such deficiency.

The effect of this regulation on Commodity Credit Corporation loans enables the farmer, and the purpose of it is to enable the farmer, to place the income from a crop and the expense of raising it in the same tax year.

Unharvested Crops

The Revenue Act of 1951 added somewhat to the elections available to a farmer in controlling his taxable income in those cases in which he sells all or a part of his farm land. The Revenue Act of 1951 changed Section 117(j)(1) by providing that the term, "property used in the

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[6] 1 T.C. 746 (1943).

trade or business," "includes timber or coal, with respect to which subsection k(1) or (2) is applicable, and unharvested crops, to which paragraph (3) is applicable."[7]

If the farmer waits to sell his land until he has a good crop upon it, he can secure the advantage of the capital gains provisions for the crop, as well as with respect to the land, provided he sells the land with the unharvested crop upon it as part of the deal. Of course, he must capitalize the expenses of growing the crops rather than deducting them as ordinary business expenses. Suppose we have a farmer with 160 acres of land upon which in September he anticipates a good corn crop. If he waited until the corn was harvested and realized 65 bushels per acre, he would get 10,400 bushels of corn which, at $1.60 per bushel, would sell for $16,-640.00. If he sells the land and unharvested corn in September, he should be able to get the capital gains benefit for the whole, providing he has held the land for more than six months. If he had waited to sell it until, say, November when the corn had been harvested, he would have had $16,640 of ordinary income, less expenses of production. There still are some uncertainties involved here. "Unharvested" would seem to mean any crop, whether ripe or not, which is "unharvested." However, it may be that the Government will claim that "unharvested" means unripe. If so, perhaps in certain cases the land and crops could be sold some time before the crop is ripe. It is possible in some crops to estimate values where the crops are well along toward maturity but not quite ripe. The advantages of achieving the benefit of capital-gains treatment in crops of high value is tremendous.

Closing Out Sale

Some farmers, especially on the cash basis, accumulate a lot of untaxed income, such as unsold crops and unsold livestock. If they sell the crops and the livestock and the farm in one taxable year, they may find themselves in a tremendously high tax bracket. This is especially so at this time, when farm land is selling at substantially increased prices over what it was purchased for fifteen or twenty years ago. A farmer who sells his land and perhaps a grain crop, machinery, and livestock on hand in one year may find that a substantial part of the total receipts will have to be disbursed to the government in the form of income taxes. This income can be spread out over more than one year by perhaps selling the grain and livestock in one taxable year and consummating the sale of the

[7]Section 117(j) was also amended by adding subparagraph (3), which provides: ". . . unharvested crop on land used in the trade or business and held for more than six months, if the crop and land are sold or exchanged or compulsorily or involuntarily converted as described in paragraph (2) at the same time and to the same person, the crop shall be considered as property used in the trade or business."

farm the following March. The gain on the sale of the farm may be further spread over a period of future years by selling it on the installment basis. A little advance planning here may be of particular benefit to older persons who are retiring after a lifetime of farming and will have relatively little taxable income in their remaining years. A husband and wife, both over 65 years, with $2,400 in exemptions, can avoid most of the taxes on gain on the value of their farm by spreading it over several years, and they should not be taxed all in one year on increment in value that occurred over a long number of years.

Section 117(j)

Farmers have available to them, as do other taxpayers, certain options to increase or reduce their income because of transactions arising out of the sale or exchange of Section 117(j) property. For instance, if a farmer has purchased a breeding animal for the sum of $2,000 and the animal turns out to be a failure and must be sold at a loss for the sum of $400, he has a loss of $1,600 less depreciation. If he has on hand another breeding animal or 117(j) asset which he has in mind selling at a profit of perhaps $1,500, the farmer can benefit tax-wise by selling the breeding animal at a loss of $1,600 in one year and taking the full loss, and selling the other asset in another taxable year at a gain, only 50 per cent of which is taxable. If he sold them both in the same year, of course, the loss would have to be offset against the gain and full utilization could not be made of the law.

Preparatory and Development Expenses

Expenditures preparatory to putting a farm, a ranch, or an orchard into production must be capitalized. Illustrative of these expenses are cost of removing trees and stumps, of clearing brush, of leveling and conditioning land, the cost of planting trees, and the cost of the trees, drilling and equipping wells, building irrigation canals and ditches, laying irrigation pipes, installing drain tile or ditches to prevent erosion, straightening creek beds to correct erosion, constructing earthen, masonry, or concrete tanks, reservoirs, dams or ditches, building roads, and the cost of physical equipment having a life in excess of one year. The above types of expenses, generally speaking, are required to be capitalized as preparatory expenses. However, there are other expenses classified as development expenses which are incurred during the development period which represent ordinary and necessary expenses as an incident to current operations, such as the upkeep of the grove or orchard, taxes for water for irrigation purposes, the cultivation and spraying of trees, etc., which the farmer may capitalize or which he may deduct as current expenses at his option. If a farmer is planting a new orchard and has no other or-

chards in production currently, he may wish to capitalize these development expenses and secure some tax benefit later when the orchards get into production. However, if he has considerable current income, he may wish to deduct these expenses as current expenses. Not all of the development expenses can be taken advantage of later xcept in event of sale.[8]

Crop Shares

The above Regulation 111, Section 29.22(a)-7,[9] permits farmers who rent out some of their land on the crop-share basis to control the year in which they wish to report the proceeds by virtue of the fact that they have it within their hands to determine the year in which they wish to reduce the crop shares to money or its equivalent. This section also allows persons who invest in farm land to control the farm income. If they have a good year from their income sources, they may wish to defer the sale of their crop share until the following year, or, if they have a poor year from their other income sources, they may wish to sell their crops and report the income in the year in which their other income is relatively small.

Crop Basis

Regulation 111, Section 29.23(a) (11),[10] enables farmers to deduct the expenses of long-time crops in the year in which they sell their crops, providing they have the consent of the Commissioner. There are not too many crops of a nature which take more than a year from the time of planting to the time of gathering and disposal, but persons engaged in the production of such crops do have this advantage available to them so that their expenses and income are reported in the same year and offset each other, rather than having expenses in one year and income in a later year.

Accrual Basis

Farmers, of course, may use the accrual basis of accounting wherein the values of livestock and grain on hand are reflected in inventory. The accrual basis of accounting with reference to farmers is similar to the accrual basis used by other business organizations, and it does tend to even out income over various years. The farmer who wishes to use the accrual basis may use any one of four methods of inventory:

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[8]MEM. 6030, 1946-2 CUM. BULL. 45 (1946).

[9]"Rents received in crop shares shall be returned as of the year in which the crop shares are reduced to money or the equivalent of money."

[10]"Where a farmer is engaged in producing crops which take more than a year from the time of planting to the process of gathering and disposal, expenses deducted may, with the consent of the Commissioner, be determined upon the crop basis, and such deductions must be taken in the year in which the gross income from the crop has been realized."

(1) The cost method;

(2) The cost or market method, whichever is lower;

(3) The farm-price method, and

(4) The unit-livestock method.

The farmer who contemplates using the accrual method of accounting must maintain a satisfactory set of books and records so that his inventories can be accounted for. The great bulk of the farmers in the Mid-West, at least, are on the cash basis and many of them could not use the accrual method because of insufficient books and records.

In times of rising prices, the accrual basis generally results in reporting higher income in the year of the rise because of gains reflected in closing inventories. From the liquid cash position point of view, it may not be as much favored by some farmers as the cash basis of reporting because of the fact that, when reporting on the cash basis, the farmer has the cash available with which to pay his taxes from the proceeds of his sales which created his income. The accrual method assists farmers who make a closing-out sale because they have previously been taxed on their opening inventory values and so do not accrue so much income in the year of the sale.

A complete discussion of the various methods of inventory available to farmers is the subject of a major treatise in itself.

It may be sufficient to say that the use of the accrual method does tend to equalize farm income over the years and is quite advantageous in this respect.

Conclusion

The law allows farmers many methods of controlling their taxable income. Many farmers are not fully cognizant of the extent of their opportunities. Farmers should take advantage of their various provisions, not to avoid paying taxes legitimately due, but to avoid paying excessive taxes not required by the law.

The Lumberman—Elect Carefully—Contract Wisely

*Ellis T. Williams**

The subject of this discussion will be the timber tax amendments of 1943, better known as Sections 117(k) (1) and 117(k) (2) of the Internal Revenue Code. By way of introduction, however, the situation as it existed before enactment of Section 117(k) will be discussed.

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*Division of Forest Economics, Department of Agriculture, Washington, D. C. (The views expressed are those of the author.)

During a period of eight years following passage of the Revenue Act of 1913, capital gains of all types were subject to the same rates of taxation as other income.[1] The problem of capital gains, therefore, as we know it today, did not arise. Beginning with the Revenue Act of 1921, however, capital gains were accorded different treatment from that given ordinary income, at first through use of a maximum rate of 12½ percent and later through use of a step scale plan based upon the period that assets had been held by the taxpayer. Today, of course, we use a combination of the step scale plan (differentiating between assets held more than six months and those held for six months or less) and a flat rate maximum recently increased from 25 per cent to 26 per cent.

When capital gains are treated differently than ordinary income, troublesome questions of classification are likely to come up. These questions are the more difficult since the Internal Revenue Code nowhere tells us what are capital assets, but merely tells us what are not. As one tax writer put it, the law defines the hole but not the doughnut.

A sale of standing timber was usually regarded as the sale of a capital asset unless it ran afoul of the following exclusion:

> "The term 'capital assets'. . . does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. . . ."[2]

In other words, if a sale of standing timber could clear this hurdle, capital gains treatment would normally be permitted. Generally speaking, it appeared that only a dealer engaged in buying and selling standing timber or timberland was likely to have his sales proceeds classified as ordinary income. The typical sale of standing timber by a timber owner led to capital gains treatment.

The owner who cut his timber and sold the resulting products in the form of logs, lumber, mine timbers, fence posts, etc., was of course in a different position since such sales did involve property includible in inventory and held for sale to customers. The owner who cut his own timber and sold the products was thus less favorably situated than the owner who sold his timber on the stump for processing by others. It was to remove this discrimination that Section 117(k)(1) was adopted.

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[1]Wells, *Legislative History of Treatment of Capital Gains Under the Federal Income Taxes, 1913-1948*, 2 NAT. TAX. J. 12 (1949).

[2]INT. REV. CODE § 117(a).

An additional factor entered the situation in 1941 as the result of a Bureau of Internal Revenue memorandum having to do with gross income deductions in the case of mines, oil and gas wells, and other natural deposits.[3] The memorandum held that recipients of income under a lease providing for royalty payments of stated amounts per unit had retained an economic interest in the oil or mineral. Since there had been in fact no sale, the taxpayer could not claim capital gains treatment. This line of reasoning was then applied to timber sales with the result that a sale of standing timber under a pay-as-cut (scale basis) contract was no longer entitled to capital gains treatment. It was to remove this discrimination that Section 117(k)(2) was adopted.

Sharp wartime increases in tax rates on ordinary income without commensurate increases in tax rates on capital gains were a factor in bringing the matter to a head, and the result was the inclusion of Section 117(k) in the Revenue Act of 1943. Reversing the usual order, I shall take up Section 117(k)(2) first, since it is the simpler provision of the two and contains no optional clause with respect to its use. Before doing so, however, I want to refer briefly to the calculation of the depletion allowance, since this problem is common to both 117(k)(1) and 117(k)(2).

The depletion allowance, in its simplest form, is nothing more than an allocation of the original cost or other basis of the timber to the units sold or cut. This allowance, together with expenses of sale, is then deducted from the gross sales price in order to determine the gain or loss recognized for tax purposes. The Treasury Regulations[4] deal at considerable length with the whole subject of timber depletion, while the information to be furnished by the taxpayer, together with some explanatory material, will be found in the Bureau of Internal Revenue's Forest Industries Schedule, referred to as Form T (Timber). Although any timber owner claiming depletion or depreciation may be required to complete Form T, it is understood that in practice only the larger timber owners are required to do so.

Three elements that need to be understood in connection with the depletion allowance are the basis for depletion, the adjusted basis, and the unit depletion. In finding the basis of the timber the approach is similar in many respects to that used in determining the basis of property in general, but special problems are likely to arise. The land value and the timber value as of the date of acquisition or other basic date must be

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[3]Briggs, *1952 Tax Treatment of Timber Cutting Under Section 117(k)(1)* 16 (Forest Industries Committee on Timber Valuation and Taxation, Washington, D.C.).

[4]U.S. Treas. Reg. 111, § 29.23(m)20-28.

separated, since only the investment in the timber is subject to depletion. The value assigned to bare land in the case of recent purchases should reflect present-day conditions, and it is understood that the former rule of thumb of one dollar per acre is no longer acceptable. If desired, some value may be assigned to young growth of unmerchantable size and this may then be allocated to the timber account when the timber becomes merchantable. The value assigned to timber as of 1913 or other basic date will take into account only the volume merchantable as of that time, according to the standards of utilization then prevailing in the area. This volume may be difficult to estimate with accuracy and the assistance of a forester will perhaps be needed. Once determined, the volume will be multiplied by a fair unit value for the species and region in question.

The adjusted basis for depletion will reflect increases in the basis by reason of acquisition of additional timber or capitalization of expenditures that have not been expensed from year to year. The adjusted basis will also reflect any reductions resulting from previous timber sales or casualty losses.

The unit depletion is found by dividing the adjusted basis by the total volume of merchantable timber on hand expressed in board feet, cords, or other unit. Timber volume should be adjusted for growth preferable each year, but at least at five-year intervals. While a timber survey or cruise is not required for making such growth adjustments, the taxpayer should indicate the percentage, acreage, or other basis of adjustment used. The depletion allowance, as has been indicated, is found by multiplying the depletion unit by the number of units sold or cut.

If the stand is not of reasonably uniform quality, but a mixed one containing varied species of differing value, the unit depletion may be calculated on a species or selection basis rather than as an average over the stand as a whole. This is accomplished by establishing separate depletion accounts and allocating a proper portion of the total basis to each. If a separation of this kind is made, the removal of low value trees, as, for example, in an improvement cutting, will not reduce the basis for depletion disproportionately. Likewise, removal of high quality trees, as for veneer, will result in a higher depletion being taken. If species or other selective depletion is claimed, the taxpayer should attach an explanatory statement to his return.

Let us turn now to consideration of Section 117(k)(2). This section, it will be recalled, permits an owner to take advantage of capital gains treatment when he sells, subject to a cutting contract, timber that he has held for more than six months prior to disposal. The operation of Section 117(k)(2) is not difficult and need not detain us long. First,

what is a cutting contract and, second, how is the six months holding period calculated?

The term "cutting contract" is not used in the Code, but rather Section 117(k) (2) uses the language "any form or type of contract by virtue of which the owner retains an economic interest in such timber." Briggs, in discussing the question of economic interest, states, "it is safe to say that an economic interest is retained by the owner where he is to be paid:

"(a) so much per thousand as the stumpage is cut

(b) out of the production from the stumpage disposed of; or

(c) out of the gross proceeds of the sale of the product of the stumpage by his transferee."[5]

Actually, the section will doubtless apply, for the most part, to sales of a pay-as-cut nature; that is to say, where a scale as contrasted with a lump sum basis of payment is used.

As to the calculation of the six months holding period, when is "disposal" regarded as having taken place? A recent decision of the Tax Court holds that the date of the sale contract is controlling rather than the date when the timber is cut.[6] This was the *Springfield Plywood* case, the first, incidentally, under Section 117(k).[7] The practical effect of the decision is to require a timber owner to wait six months from date of timber acquisition before signing a pay-as-cut contract, if he wishes to take advantage of Section 117(k)(2).

Timber to which Section 117(k)(2) applies is specifically included in the definition of property used in the trade or business under Section 117(j). Gains or losses from sales of such timber are thus grouped with other 117(j) gains and losses. If recognized gains exceed recognized losses, each is treated as a capital gain or loss. On the other hand, if such gains do not exceed such losses, each is treated as an ordinary gain or loss.

Taking up Section 117(k)(1), it is important to remember that this section concerns the cutting of timber and not its sale as stumpage. The purpose of Section 117(k)(1), as has been pointed out, is to permit the taxpayer who cuts timber to receive the advantage of capital gains treatment and so put him on a par with the taxpayer who sells his timber on the stump. The section accomplishes its purpose by treating the timber

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[5]Briggs, *op. cit. supra.* note 3, at 17.
[6]Springfield Plywood Corp., 15 T.C. 697 (1950).
[7]Stoel, *Timber Cutting and Timber Sales Under Section 117(k) of the Internal Revenue Code,* 30 Ore. L. Rev. 306 (June 1951).

cutting as a fictional sale of the timber by the holder to himself at the fair market value prevailing on the first day of the taxable year. In effect, there are thus two separate and distinct parts of the over-all transaction. First, there is the change in value between the depletion allowance and the stumpage value of the timber cut at time of cutting. This change in value is treated as a capital gain or loss (or more strictly speaking as a 117(j) gain or loss) just as though the timber actually had been sold standing. Second, there is the change in value between the stumpage value at time of cutting and the sales proceeds of the logs, lumber, pulpwood, or other products—less, of course, cutting, transportation, and processing costs. This latter change in value can be thought of as the value added by manufacture. It is taxed as ordinary income.

Let us see just who may make use of Section 117(k)(1) and under what circumstances. On the first count, the section may be used either by a taxpayer who owns timber or by one who has a contract right to cut timber, as, for example, a purchaser under a pay-as-cut contract. On the second count, the circumstances under which the section applies are three in number. One, the timber in question must be intended for sale or for use in the taxpayer's trade or business. Two, the taxpayer must have owned or held the timber for a period of more than six months prior to the beginning of the taxable year. This means, for example, that if the fiscal year of the taxpayer is the calendar year, only the cutting of timber held on June 30 of the preceeding year is eligible for treatment in accordance with 117(k) (1). Three, the taxpayer must elect to use Section 117(k)(1) and must so state upon his tax return. We shall assume for the moment that the taxpayer does make the election, since it will in most situations be to his advantage to do so. A possible situation in which use of 117(k)(1) might prove disadvantageous will be mentioned later. An election, once made, is binding upon the taxpayer in subsequent years (in the absence of express permission by the Bureau of Internal Revenue to revoke the election) and for all timber which the taxpayer owns or has a contract right to cut. It is understood that in practice the Bureau readily grants permission to revoke an election but that it may then be difficult to secure authorization to return to this method of treatment at a later time.

It will be realized that the setting of fair market value is the key operation in using Section 117(k)(1) since the figure adopted as fair value is at the same time the "selling price" for purposes of determining the capital gain and the "cost" for purposes of determining the manufacturing profit or ordinary gain. To the quantity of timber cut a fair unit value must be applied. The Regulations[8] recognize that it is ordinarily not prac-

[8]U.S. Treas. Reg. 111, § 29.23(m)-21.

tical to determine the quantity of timber cut immediately after it is felled, and for purposes of accounting regard depletion as taking place at the time when, in the process of exploitation, the quantity of timber felled is first definitely determined.

The fair unit value to use must be determined in the light of all the evidence available.[9] The value sought will be the selling price, assuming a willing buyer and a willing seller, both being reasonably informed as to the facts. The regulations discuss the question of fair market value for purposes of the basis for depletion,[10] and the same principles apply when establishing fair farket value for purpose of Section 117(k)(1). Among factors to be considered are the quality of the timber as determined by species, age, size, and condition; the quantity of the timber per acre and in total and its location with reference to other timber; the accessibility of the timber; and freight rates by common carrier to important markets.

Briggs, in discussing the question of fair value,[11] points out that in the final analysis fair value must be a matter of judgment or opinion, and that opinion will carry weight to the extent that it is based upon the factual evidence available. Sales of comparable tracts, realization as a result of use or liquidation, offers to buy and sell, business and market conditions, and, in the case of recent purchases, the cost to the taxpayer may need to be taken into consideration.

As would be expected, the Bureau of Internal Revenue pays close attention to the fair market value adopted, since it is the critical factor in determining how much of the gross income from timber operations is capital gain and how much is ordinary gain. The taxpayer should be prepared to support the unit value that he has used and should preserve pertinent valuation, data.

There has been some dissatisfaction at times because the highest bid prices in Forest Service sales have not necessarily been accepted as proving fair market value. It is understood that the Bureau of Internal Revenue takes the position that market prices are affected by the lower as well as by the higher sales, and by private transactions as well as public auctions. All transactions in comparable timber have a bearing on the fair market value to use. As a practical matter, there will frequently be a going market price for comparable stumpage that may be used by the taxpayer as a guide. The larger timber owners will often have data from their own open market purchases of similar timber and such information will usually be available to the smaller owners as well.

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[9] *Id.* § 29.117-8 (1943).
[10] *Id.* § 29.23(m)-25.
[11] Briggs, *op. cit. supra* note 3, at 7-11 (1943).

Once the fair unit value has been established, it is multiplied by the number of units cut and the product will be the "selling price" of the stumpage for purposes of the section. The adjusted basis of the timber cut is substracted and the recognized gain or loss from the cutting of timber is then grouped with other 117(j) gains and losses, as in the case of gains and losses under Section 117(k)(2).

With respect to the conversion or manufacturing profit, Section 117(k)(1) provides that the fair market value as of the first day of the taxable year shall "thereafter be considered as the cost of such timber to the taxpayer for all purposes for which such cost is a necessary factor." The timber cut by the taxpayer is thus treated in exactly the same way as though it had in fact been purchased from another at the fair market value in question.

The Regulations[12] make clear that this "cost" is to be used irrespective of whether or not the timber products are sold during the year in which cut or are included in inventory at the close of such year. In the latter case, the fair market value adopted is treated as cost in computing the closing inventory for the year of cutting and the opening inventory for the following year. The costs of cutting, logging, and all other expenses forming a part of the cost of converting the standing timber into the products in inventory are included along with the fair market value or hypothetical cost in arriving at the inventory value to use. The fact that fair market value as of the first day of the year in which the timber is cut, is used as the cost of the timber does not in any way interfere with use of the "cost or market, whichever is the lower" method of computing inventories, or with the so-called elective or "last in first out" method if such methods are in use by the taxpayer.

Before leaving our consideration of Section 117(k)(1), two additional points should be touched upon. First, what disadvantages to the timber owner might result from his use of this optional method? Second, what interpretation should be placed upon the term timber as used in the section?

In answer to the first question, it appears unlikely, although in theory possible, that use of Section 117(k)(1) would cost the timber owner more in taxes than if he had not made the election to use it. Suppose, for example, that the price of stumpage fell, with the result that the fair market value adopted was less than the taxpayer's adjusted basis for depletion. The timber owner now has a long-term loss and under the provisions of Section 117(j) would have to report it as a capital loss, rather than as

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[12]U. S. Treas. Reg. 111, § 29.117-8 (1943).

an ordinary loss, if aggregate gains under that section exceeded aggregate 117(j) losses. At the same time the inventory cost of the logs or other products would reflect the lower hypothetical cost, as contrasted with the higher original cost, and manufacturing profit would be correspondingly increased. The occurrence of a combination of circumstances such as outlined above would seem to be remote, however, and in general the taxpayer can look forward to a tax saving through use of Section 117(k)(1).

The use of the optional method requires a somewhat more detailed tax calculation than would otherwise be the case and this will constitute a disadvantage to some, particularly the smaller owners.

Still another possible disadvantage lies in the fact that when Section 117(k)(1) is first adopted, the tax on the increment of value up to time of cutting may have to be paid before the resulting products have been sold and before cash proceeds are in hand. This situation tends to be self-correcting, however, as the taxpayer continues to operate under the provisions of Section 117(k)(1) and as processing and sales take place from year to year.

The second question concerns the meaning of the term "timber" within the contemplation of the section. It may be asked, for example, whether pulpwood, stumps, poles and piling, bark, and pine straw fall within the category of timber or whether the term is restricted to sawtimber alone. Neither the Code nor the Regulations indicate what is meant by timber, but the context makes clear that it is standing timber, that is to say, stumpage that is intended. Thus, the Regulations at one point[13] refer to separating the value of the land from the value of the timber, at another point[14] reference is made to growth of timber. Again a distinction is made[15] between timber and the products of the timber. It is difficult to see how the harvesting of products, such as naval stores, from the standing tree could be brought under Section 117(k)(1). Moreover, logs, lumber, pulpwood, mine timbers, fence post, etc., fall within the category of the products of timber rather than of timber itself.

If, then, we think of timber in the sense of standing timber or stumpage, are there any types of trees that would be unable to qualify timber under Section 117(k)(1)? It would seem that fruit and nut trees clearly lie outside the pale. Christmas trees raise a more difficult question, and a ruling from the Bureau of Internal Revenue should perhaps be secured, since the timber status of Christmas trees has not as yet been determined. It is sometimes asked whether thinnings and release cuttings can be brought

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[13] *Id.* § 29.23(m)-27 (1943).
[14] *Id.* § 29.23(m)-26 (1943).
[15] *Id.* § 29.117-8 (1943).

under Section 117(k)(1). While no hard and fast rule can be laid down, it would seem that a reasonable test is to ask whether the products in question meet the standards of utilization prevailing in the particular region at the time.

We have been considering the income tax treatment of receipts from sales of timber and forest products but should give some attention to the treatment of the costs of forest ownership and operation, since these also can raise perplexing questions for the timber owner.

Ordinary and necessary expenses directly related to timber operations are, of course, expensed from year to year. Under this heading will come costs of logging, transportation and processing, including labor, hire of trucks, tractors and other machinery, and hire of animals. Also expensed will be purchases of materials and supplies including tools of short life or small cost, such as axes, saws, sledges, etc. Construction of temporary roads, fire protection costs, and management expenses will also be expensed.

In the handling of the depreciation account the special provision[16] of the Regulations with reference to timber plant and equipment should be borne in mind. Such property may either be depreciated according to the usual rules for depreciation or at a rate established by current exhaustion of stumpage, provided that it is not written off prior to the termination of its useful life.

The capital expeditures of the timber owner will include those for acquisition of land and timber and for equipment having a useful life of more than one year. Also capitalized will be expenditures for permanent improvements and betterments. Land improvements will include ditching and grading and construction of permanent roads, including firebreaks. Such improvements as those named are not subject to depreciation. Other types of land improvements, on the other hand, such as bridges, culverts, and fences, may be depreciated. Main-line or permanent roads present a special problem. If it can be shown that such roads, once the timber to which they give access has been cut, will not be needed again until a new crop of timber has grown and that such roads are in fact depreciating during the waiting period, recovery of the capital investment through depreciation may be permitted.

Seeding and planting can be thought of as a "timber improvement" and costs of this kind must be capitalized although recoverable through depletion. Probably no items of expenditure incurred by the timber owner

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[16] *Id.* § 29.23(n)-23 (1943).

have been the subject of more discussion than have those for seeding and planting, and numerous suggestions have been made that the Code and Regulations be amended to permit expensing such costs. In support of this change it is claimed that the social benefits resulting from increased planting would outweigh any loss of revenue that might occur. Moreover, the reduction of revenue would be offset, at least in part, when the planted trees were harvested. This would result from the fact that the depletion allowance would be less and the recognized gain correspondingly greater by reason of planting costs having been expensed rather than capitalized and thus added to the basis for depletion.

Of particular interest to timber owners, by reason of the relatively long period that may elapse before receipt of income, are carrying charges and development expenditures.[17] Since such costs may either be expensed or capitalized at the option of the taxpayer, provided the treatment is consistent, they fall in a sense midway between operating expenses, on the one hand, and capital expenditures, upon the other. Carrying charges will include annual taxes, interest, and fire protection costs during the period that a property is unproductive. Development expenditures will include cost of girdling, poisoning, pruning, and improvement cuttings, but should be reduced by any amounts received for salable products. Most taxpayers will doubtless prefer to expense such items as qualify for this treatment, although in certain cases an owner might prefer to capitalize his carrying charges or development expenditures with a view to increasing his basis for depletion and reducing his ultimate capital gain.

The income tax treatment of timber losses from fire, windstorm, or other casualty such as disease or insect infestation will follow that accorded casualty losses in general. A provision of the Code that will doubtless become of increasing importance as timber insurance is made available, is the section concerning non-recognition of gain when proceeds are reinvested in property similar or related in use to the damaged property.[18] This provision could be of material assistance to an insured timber-owner suffering loss by forest fire, for example, if his basis for depletion were low as compared with the insurance proceeds. Re-investment in timber property in accordance with the Regulations would serve to eliminate a taxable gain, and would at the same time maintain the taxpayer's investment in growing timber.

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[17] INT. REV. CODE § 29(a)(7); U.S.Treas. Reg. 111, § 29.24-5 (1943).
[18] INT. REV. CODE § 112(f); U.S. Treas. Reg. 111, § 29.112(f)-1 (1943).

State Bar Section

SPIRITUAL VALUES OF THE PROFESSION OF LAW

*W. N. Ethridge**

You gentlemen are beginning upon a career in a profession which is worthy of your whole intelligence. How close to mankind is this abstraction called the law! As in a magic mirror, it reflects not only our own lives but the lives of all men that have been. It is a story which has unfolded day by day throughout the history of the human race. The law has been culled slowly, painstakingly, from ancient documents, from Bracton and Gaius, from reports of tribes living centuries ago in the German forests, from Hebrew manuscripts, and from Cicero, Coke, Mansfield, Story, Kent, and Holmes. In brief, the law is in part a tale of what men have most believed and most wanted.

It is also the calling of thinkers, of men who will take an idea or a case-precedent not as a postulate to be accepted, but as a thesis to be debated and analyzed, as food for criticism and discussion; of men who will approach a problem or an issue with minds unclouded by prejudice, selfishness, or narrow perspective.

And of equal importance, the law is a living challenge to the lawyer—a challenge to serve his clients ably and faithfully, the courts honestly and respectfully, and the public welfare willingly and effectively. It is in the numerous opportunities for public service that you young men have the chance to pay rent for the space which you occupy on this planet. As county attorneys, district attorneys, judges, and legislators, you are trained to participate intelligently and independently in the public life of your communities. And no other calling gives you such scope to realize the spontaneous energy of one's soul—no other calling lets one plunge so deep into the stream of life, so share its battles, its passions, its despair, and its triumph.

But you must be worthy of these opportunities which your new profession offers. Its great traditions have in some respect declined since our grandfathers' time. But the members of the bar today have in general a broader base of education and of professional competency than ever before in the history of the Mississippi Bar. And they will expect the excellent training which you have received at Ole Miss to measure up to these standards of proficiency. You can do that only by hard work and a vigorous in-

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*An address delivered by Supreme Court Justice W. N. Ethridge, Jr., of Oxford, Mississippi, on June 2, 1952, to the graduates of the University of Mississippi Law School upon their admission to the bar of the Supreme Court of Mississippi.

terest in your profession. The fact that you are here today indicates that you are capable of that. Of equal importance, you have an obligation to your community and state which you should attempt to repay by some type of faithful public service. Above all, your paths should be determined by the principles and life of Him who lived and died for each of us.

The great traditions and ideals of the law are the things that ennoble it, the things which it really is in its best and truest moments. These traditions of integrity, fairness, intelligence and public service are a bond between the members of the profession in one of the great concerns of man, the cause of justice upon earth. Without these eternal values of the spirit the profession of the law would wither and die. We are fallen upon days that are spoken of by many as cynical and sordid. But it has been given to you and to all of the members of the legal profession to prove in our own lives and profession that the truth is in these traditions and purposes of the law. Your diplomas and your admission to the bar charge you with these responsibilities. My bretheren and I welcome you to the bar of this Court. May you serve your profession and the public in a manner worthy of the highest traditions of your calling and of the administration of justice.

NOTES

FUNCTION OF THE ANTITRUST DIVISION UNDER THE DEFENSE PRODUCTION ACT OF 1950

*Shirley J. Norwood**

In order to achieve the goal of the defense program, it is essential that the mobilization program be understood. We must preserve free enterprise while building our defenses in order that we may continue to maintain a competitive society in the future.

The role of the Department of Justice in this mobilization program is twofold. First, under the Defense Production Act of 1950 the Attorney General is charged with specific responsibilities regarding voluntary agreements and programs, litigation, and reports to Congress and the President. The second and more important responsibility, as stated by former Attorney General McGrath, is the obligation to insure the continuation of the competitive structure of our economy during the course of building our military power.[1]

In order to reduce the danger to our economic system during the period of mobilization, Congress, in the declaration of policy of the Defense Production Act, requires that mobilization proceed, so far as practicable, within the framework of competitive enterprise. The President has emphasized the importance of this policy. He pointed out in his State of the Union Message in January, 1947, that economic concentration during the last war had been accelerated. In numerous provisions of the Defense Production Act of 1950 Congress indicated its concern over this danger to free enterprise.[2]

The President directed all defense agencies to consult with the Attorney General and Chairman of the Federal Trade Commission for the purpose of determining and, to the extent consistent with the principal objectives of the Act, eliminating any factors which tend to suppress competition unduly, create or strengthen monopolies, injure small businesses or otherwise promote the concentration of economic power.[3]

As a result of these declarations by Congress and the President, the Department of Justice, through consultation, provides guidance to defense

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*B.A., Millsaps College; LL.B., University of Mississippi, 1952; member firm of Watkins, Edwards & Ludlam, Jackson, Mississipppi.

[1]Address by J. Howard McGrath, Attorney General, before Institute on Economics of Defense Mobilization, Dept. of Commerce Auditorium (November 27, 1951).

[2]Letter of President Truman (September 28, 1950).

[3]*Ibid.*

officials in determining the competitive effect of numerous proposed defense activities. Except for certain litigation functions the responsibilities of the Department of Justice under the executory and statutory mandates have been assigned to its Antitrust Division.[4] The consultations which arise out of expressions on the part of the President and Congress constitute a major defense activity of the Antitrust Division.[5]

An example of the work of the Antitrust Division is found in connection with the aluminum expansion program now being sponsored by the government. In its decision in the *Alcoa Case* in 1950 the trial court held that competitive conditions had not been established and did not in fact exist in the aluminum industry.[6] There are only three producers of primary aluminum. It is the policy of the Antitrust Division to encourage the expansion of the primary aluminum industry, introducing into it independent producers.[7]

Section 708(e) of the Defense Production Act of 1950 (Public Law 774, 81st Congress), approved September 8, 1950, provides that:

> The Attorney General is directed to make, or request the Federal Trade Commission to make for him, surveys for the purpose of determining any factors which may tend to eliminate competition, create or strengthen monopolies, injure small business, or otherwise promote undue concentration of economic power in the course of the administration of this Act.

The Act further provides that the Attorney General shall submit to Congress and the President reports setting forth the results of such surveys and including such recommendations as he deems advisable.

In his first report the Attorney General pointed out the dangers to a competitive economy which are inherent in mobilization for defense, and discussed certain policies to minimize those dangers. He stated[8] that the Defense Production Act reflects an awareness on the part of Congress of the fundamental problem of maintaining competition in a mobilization effort of indeterminable duration. Congress expressed concern with regard to the position of small business in the mobilization effort. The Act directs the President to provide such enterprises with full information on the activities of the departments and agencies under the Act where such information relates to, or is of benefit to, such independent enterprises.[9]

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[4]McGrath, *op. cit. supra* note 1, at 2.
[5]Abrams, *Antitrust Laws in National Emergency*, 36 MINN. L. REV. 490 (1952).
[6]U.S. v. Aluminum Company of America, 91 F. Supp. 333 (S.D. N.Y. 1950).
[7]Abrams, *op. cit. supra* note 6.
[8]REP. ATT'Y GEN. PURSUANT TO SECTION 708(e) OF THE DEFENSE PRODUCTION ACT of 1950, 4 (December 7, 1950).
[9]*Id.* at 5.

Where the period of mobilization is indefinite, long range as well as short range effects must be carefully considered. A balance must be taken between immediate necessities and long range effects. Obviously, the sooner emergency regulations are withdrawn, the less likelihood there will be of permanent injury to the economy.

In the past the government adopted the policy of financing research by private organizations.[10] This policy has tended to expand the research facilities of a few large organizations. When information so obtained is not disseminated, industry cannot operate with maximum efficiency and capacity. During World War I the antitrust laws permitted an attack on some of the most critical concentrations of control over technology. Such methods were, however, available only where it could be established that patents had been used to implement restraints of trade.[11] The focusing of the bulk of government financed research in a small number of corporations gave added impetus to the trend toward concentration of economic activity.

The competitive economy is also likely to suffer from price controls unless management of these controls is undertaken with unusual care. Restrictive fiscal measures also have a great effect on the national economy. Maladjustment in the use of credit to the disadvantage of the small business may be inevitable; but to the extent that fiscal controls can be used instead of more direct price and production controls, they are to be preferred.[12] However, after June 30, 1952, no voluntary program or agreement for the control of credit can be approved under Section 708.[13]

After the initial stages of a war-induced shortage, the emphasis on private allocation declines and government regulations, through voluntary agreements or mandatory orders, are invoked to insure uniform action in determining allocation policies and practices. Allocation measures, whether adopted as a result of voluntary agreements or mandatory regulations, differ in their effect on the economy. Limitation orders put the greatest pressure on producers who cannot shift to the production of other products.[14]

To a certain extent government policy has restricted competition in the belief that in the long run a free, competitive economy can thereby best be preserved. In the hearings on the mobilization program, the Subcommittee on the Study of Monopoly Power had as goals the preservation of a free competitive economy as well as the expanding of America's

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[10] *Id.* at 10.
[11] *Id.* at 15.
[12] *Id.* at 27.
[13] Defense Production Act of 1950 § 708, as amended June, 1952.
[14] See note 8 *supra*, at 22.

military defenses and the prevention of inflation.[15] The specific interest of the subcommittee in the investigation was to study the effect of the mobilization program on that part of the national policy which is expressed in and protected by the antitrust laws. Certain guide lines have been established with reference to antitrust phases of the program, but these have been inadequate and often confused and conflcting.

Voluntary Agreements

In obtaining aid from business, it has repeatedly been deemed necessary to ask groups of competitors to meet together for various purposes and, at times, to take cooperative action which would never be tolerated in normal times. A temporary conflict between the Sherman Act and certain phases of the mobilization program is inevitable. This conflict has been evident in the field of voluntary agreements which have been exempted from the antitrust laws, in the activities of industry advisory committees, and in the adoption of government regulations establishing methods of controlling prices and production.[16]

The Defense Production Act of 1950 was passed promptly after the eruption of the Korean hostilities. It provides for a comprehensive scheme of government controls designed to place the entire economy upon a mobilization footing. Title VII, in addition to a number of other provisions, includes sections relating to small business, the establishment of industry advisory committees, exemptions from the antitrust laws, and the employment of personnel without compensation.

The D.P.A., Section 404, directs the President actively to seek the cooperation of private industry in the administration of economic controls. It was the over-all policy of the Act to encourage voluntary cooperation between business and government. It is inevitable that antitrust problems will result from any such widespread program of promoting voluntary cooperation by business. At times it is found that the national interest requires the government to request private industry to take action which affirmatively violates the antitrust laws.[17]

The conflict in policy between the mobilization program and the antitrust laws requires thoughtful consideration. If the antitrust laws are effectively abrogated for the duration of the emergency and reliance is placed entirely on a cartelized economy, it may become impossible ever to return to a vigorously free competitive society.

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[15]The Mobilization Program: Report of the Subcommittee on Study of Monopoly Power of the Committee of the Judiciary Pursuant to H. Rep. 95 (82d Cong. 1st Session) (1951), at 1.

[16]*Id.* at 2.

[17]*Id.* at 6.

The magnitude of the danger increases as the period of mobilization becomes more prolonged, but unless enforcement of the antitrust laws is relaxed in some instances it will be extremely difficult to secure from private industry the wholehearted cooperation which is so valuable and necessary. It would be unjust to ask for private cooperation and ignore the possibility that the acceptance of the invitation might subject a well-intentioned citizen to penalties for violation of antitrust laws. These considerations are sufficient to demonstrate the need for the establishment of plainly marked signposts to guide past these cross roads of policy. At present signposts often lead to confusion, conflict and uncertainty.[18]

There has been no repeal or suspension of the antitrust laws for the mobilization period. The provision in Section 708 of the Defense Production Act exempts specific activities from antitrust laws only on condition that certain detailed procedures are followed. Except for these special exemptions the antitrust laws remain in force. If competitors take joint action, even though at the behest of the government, they may violate the antitrust laws and be subject to penalties including possible payment of treble damages.[19]

One of two alternatives must be taken whenever the government seeks voluntary cooperation from industry. (1) If there is substantial danger that the requested voluntary action would violate the antitrust laws and if national interest nevertheless makes such action desirable, an antitrust exemption should be obtained under 708 of the D.P.A. (2) The government should be sure it is not fostering possible violations of antitrust laws. Government officials under Section 708 of the D.P.A. are to obtain the approval of the Attorney General prior to requesting private groups to participate in a voluntary agreement.

In practice, processing of voluntary agreements in the Antitrust Division commences with informal preliminary discussions between representatives of that Division and the initiating agency. In these discussions an effort is made to form agreements which will accomplish the desired objective of the initiating agency and at the same time have as little undesirable effect as possible on competition. Following these informal preliminary discussions, drafts of proposed agreements are submitted for formal consultation among representatives of the Antitrust Division, Federal Trade Commission, initiating agency and the Defense Production Administrator pursuant to 708(c) of the Act. At the conclusion of such consultations, each voluntary agreement is submitted to the Attorney General for his approval.[20]

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[18] *Id.* at 7.
[19] *Ibid.*
[20] McGrath, *op. cit. supra* note 1, at 3.

Conduct in violation of the antitrust laws may be authorized. The exempt activities are limited to those necessary to accomplish the desired objective of the agreement. The terms of each agreement define the scope of such permissible cooperative activity; any activity beyond that authorized is subject to the antitrust laws. Thirty voluntary agreements have been approved.[21]

Defense Production Pools represent one type of voluntary cooperative program which has been approved under the D.P.A. A production pool is an association of small manufacturing firms organized for the purpose of jointly obtaining and performing defense contracts.[22] Small manufacturers by combining their capital and production facilities in the pool are enabled to participate in defense contracts from which they would otherwise be excluded. The advantages to the government from pools include increased capacity for defense production, accelerated rate of defense production, decentralization, and the prevention of loss of productive capacity during partial mobilization. Production pools may be incorporated or unincorporated. They may be composed of manufacturers with complementary plant facilities or with similar facilities.

Integration committees represent another kind of voluntary cooperative agreement used by the Department of the Army. This type of agreement also must be approved. These committees are composed of all the manufacturers under contract with the Army to produce the item covered by the agreement. New enterprises become eligible to participate in the agreement as they are awarded contracts to produce the item covered. The committees exchange technical information concerning the production of the item, interchange supplies and equipment, and make recommendations for the solution of various production problems. Separate agreements have been approved for such items as optical fire control equipment, light, medium, and heavy gun tanks, rockets, artillery shells, boosters and fuses, and tactical trucks.

In authorizing the utilization of voluntary agreements and programs to further the objectives of the Act, and in providing for exemptions from the antitrust laws for activities under such agreements, the Act requires that requests for action be referred to the Attorney General and the Chairman of the Federal Trade Commission and that such exemptions be granted only with the approval of the Attorney General.[23]

The use of voluntary agreements and programs to carry out the mobilization program may result in business enterprises, vigorously com-

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[21] *Id.* at 4.
[22] *Ibid.*
[23] See note 8 *supra,* at 6.

petitive in normal times, evolving common courses of action to restrict production, retard technical development, limit expansion, reduce quality, and raise prices. To the extent that the mobilization program requires joint action by business men, opportunities are presented to work out restrictive agreements either within or without the government sponsored program.

The D.P.A. recognizes the many problems connected with the use of voluntary programs and contains provisions to meet those problems. The President or his delegate has the responsibility for determining whether or not there is a need for a joint program of business activity. Provision is also made for obtaining in advance the views of the Attorney General and the Chairman of the Federal Trade Commission with respect to each proposal to exempt such arrangements from the antitrust laws. Every request for action under such agreement requires the approval of the Attorney General.[24]

Several requirements should be complied with in order to carry out the provisions of the Act designed to insure a competitive economy:

(1) It is essential that functions delegated by the President to officials under the Act should reside exclusively in those officials and not be redelegated to non-government program members. The determination of program policy and program enforcement are examples of functions which should remain exclusively government functions.

(2) In determining whether a request for a voluntary agreement or program is in the public interest as contributing to national defense, the delegate agency should carefully weigh the degree to which competition will be eliminated by the proposed program as against the need for such a program in the mobilization effort.

(3) Voluntary programs should be administered so as to provide adequate safeguards sufficient to protect the interest of those outside the participating group, including the general public, who might be adversely affected by the operations of such programs.

Finally, it is recognized that activities under voluntary agreements and programs are likely to establish codes of conduct which may continue after expiration of the authority granted by the Act and which are inconsistent with free competition. Therefore, it is important to know that the immunity provided does not extend to activities beyond the scope of the agreement or continued beyond the duration of the Act. It is likewise important that affirmative steps be taken after expiration of the Act to

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[24] *Id.* at 28.

restore competition by elimination of institutions and practices fostered by such wartime emergency needs.[25]

In many factual situations the objectives may be achieved either by the issuance of regulations or orders by the agency concerned, or through the formation of these voluntary agreements. Former Assistant Attorney General Morison recommended[26] that serious consideration be given the former, since the regulation or order frequently will afford a greater degree of protection to the business concerned and will eliminate the necessity of agreements as to business practices between competitors. He further stated that when it is determined that voluntary agreements should be utilized, the agreement should be drawn in such manner as to accomplish the specific objective required in the public interest as contributing to the national defense and, at the same time, to insure that our competitive system is impaired to the least possible extent. Exemption from antitrust laws should be limited to the degree actually required by the facts of the particular situation.

Voluntary agreements should be so formulated as to contain procedural safeguards to protect the business participants from unjustified charges concerning their activities in the course of the program and to forestall the possibility of violations of the antitrust laws by participation in activities not exempt. Only general standards can be formulated for determination of the factual situations in which a voluntary agreement may be required to protect business participants from liability under the antitrust laws. The facts and circumstances surrounding the specific acts requested may themselves resolve whether the antitrust laws will or will not be violated by the contemplated course of action.[27]

All voluntary agreements on the part of industry representatives to follow a particular course of action or to refrain from such action must be approved if participants are to have antitrust immunity. This is true even though the acts may be solely for the benefit of the government. This rule is equally applicable to agreements reached in the course of industry advisory committee meetings. It does not matter that those who are present at a committee meeting are only a small segment of an industry. Agreement by individual business enterprises to follow a particular course of action constitutes a voluntary agreement requiring approval if, in fact, the individual is agreeing to follow the requested course of action in consideration of a similar agreement on the part of other business enterprises. Morison recommends that when doubt arises as to procedure that the af-

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[25] *Id.* at 30.
[26] Letter from Assistant Attorney General Morison (December 18, 1951).
[27] *Ibid.*

fected agency consult with representatives of the Federal Trade Commission and the Department of Justice.[28]

No defense agency has the power to grant exemption from antitrust laws unless the procedure of Section 708 is followed. There are certain statutory requirements for exemption:[29]

(1) President is authorized to consult with representatives of industry and other private interests with the idea of encouraging voluntary agreements designed to further objectives of the Act.

(2) Program or agreement contemplated must be found by the President to be in the public interest.

(3) Acts or omissions to act under such programs must be requested by the President or delegated official appointed by the President with the consent of the Senate. Persons exercising power delegated by the President must obtain prior approval by the Attorney General before making any request. Copies of requests, modifications or withdrawals must be furnished to both Attorney General and Chairman of the Federal Trade Commission.

The Defense Production Act does not delineate specific criteria for determining what types of activities should be exempted from the antitrust laws. It merely sets forth the general standard that the voluntary program must be designed "to further the objectives of this Act," and exempt activities must be "found by the President to be in the public interest as contributing to the national defense." Therefore, there is no statutory basis for excluding any particular types of agreements, such as allocation agreements, from qualification for exemption.[30] The mere fact that a particular type of agreement is illegal under the antitrust laws is not ground for denying it a Section 708 exemption. There would be no need for exemption unless the agreement would be otherwise illegal.

Instead of specifying sharply defined categories, Section 708 requires the exercise of careful judgment in balancing two conflicting policies each time a determination is made as to whether or not to grant a particular exemption. In such cases the long-run effect of a departure from our antitrust policies—the tendency of a voluntary agreement to increase the concentration of economic power or to foster enduring cartel practices—must be weighed against the anticipated contribution of the program to the defense effort.

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[28] *Ibid.*
[29] See note 15 *supra*, at 8.
[30] *Id.* at 10.

There appears to be confusion among the defense agencies as to just when it is necessary to obtain clearness under 708 for a voluntary program. Whether an exemption is necessary depends ultimately on the legality under the antitrust laws of the proposed voluntary action. Certain types of situations in which voluntary industry cooperation is sought recur repeatedly, and consistent treatment should be accorded comparable situations. An example of inconsistent treatment is provided in attempts to control steel and copper prices by voluntary means. Approval was given to a voluntary agreement not to raise steel prices. A similar exemption was not given when the Office of Price Stabilization sought similar voluntary agreements relating to the price of copper. The steel agreement was in writing; the copper, oral. It would seem that if an agreement violates the antitrust laws it is no less illegal because it is not in writing.[31]

Former Assistant Attorney General Morison differentiated between requests for voluntary cooperation made at industry meetings attended by several competitors and individual requests forwarded directly to the several companies, whether or not subsequent to a meeting at which preliminary data are secured. The difference is that in the latter case there is clearly no agreement among the members of an industry, whereas in the former instance there would be danger that the voluntary undertakings made by several competitors at a joint meeting would be regarded as an agreement among the industry members and not just a series of individual agreements between particular companies and the government.

According to Manly Fleischman, Former Administrator of the National Production Authority, a voluntary agreement under which each producer tells what his program is in the presence of others is admissible. If an N.P.A. official requested producers to undertake a voluntary allocation program and each said he would comply with the suggestion, that would be permissible.[32] His opinion and that of Morison in his letter of January 16, 1951, seem to conflict.

A unique procedure was followed by the Economic Stabilization Agency in requesting railroads to refrain from making scrap-metal sales without seven days' notice of intent to make sales and without prices being given to the Agency. Michael V. DiSalle, Former Director of Price Stabilization, was of the opinion that such an agreement would have to be approved under 708.[33]

There are some voluntary agreements in which it is extremely difficult to determine just when it is necessary to obtain approval of the At-

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[31] *Id.* at 13.
[32] *Id.* at 15.
[33] *Id.* at 18.

torney General. For example, in an address on January 25, 1951, James K. Knudson, Administrator of the Defense Transport Administration, addressing a gathering of shippers urged particular consideration of ten points. Most of these ten points were requests for individual action. However, they included a request for "greater cooperation between railroads and other forms of transportation" and Knudson stated that it would be most helpful if a formula to determine the proper amount of car ownership could be fixed by the railroads jointly. Knudson felt that it was unnecessary to clear with the Attorney General though his speech included requests for voluntary action.[34]

Section 708 of D.P.A. lacks clarity. Subsection (a) authorized the President to consult with representatives of private business and other interests to encourage voluntary agreements. When read with (b) it indicates that the President has authority to give approval to voluntary agreements itself though approved by the President. Exemption may be given only for acts or omissions to act pursuant to an agreement which has been approved. As a matter of antitrust law, it is the agreement itself which may be illegal whether or not any overt act is performed pursuant to the agreement.[35] The statutory exemption, however, is not given to the agreement, but instead is confined to acts or omission to act pursuant to the agreement. In the practical administration of the Act, however, this distinction between the program and acts pursuant to the program has been obliterated. The problem of interpretation has been handled administratively by elimination of the distinction made in the statute between the basic program and its implementation by specific acts.[36]

Industry Advisory Committees

Section 701 of the Defense Production Act provides for industry advisory committees. The Act directs the President and his delegate agencies to obtain the advice of persons substantially affected by regulations or orders issued under the Act. Since the rendering of advice by private persons is not exempt from antitrust laws, it is essential for them to avoid any possible violations. In the area of industry advisory committees the antitrust problem is to avoid any possible violations. In the area of voluntary agreements the problem is to determine when an exemption should be sought.[37]

Business advisory committees have the sole function of giving advice and making recommendations to government when requested to do so.

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[34]*Ibid.*
[35]Nash v. United States, 229 U.S. 373 (1913).
[36]See note 15 *supra,* at 22.
[37]*Ibid.*

Their decision should not serve as a vehicle for gathering information from the industry. To allow a private individual or group to request vital trade information from competitors or companies in related fields is repugnant to our system of competitive enterprise.[38]

In anticipation of antitrust problems surrounding business advisory groups, Peyton Ford, then Deputy Attorney General, in a letter of October 19, 1950, to executive departments concerned with the administration of the D.P.A., outlined standards which he considered desirable for the conduct of business advisory committees. In organizing such committees, according to Ford there are certain requirements that should be met:

(1) There must be statutory authority for the employment of such committees or there must be an administrative finding that it is necessary to utilize such committees to perform certain statutory duties.

(2) The agenda for such committees and their meetings must be initiated and formulated by the government.

(3) The meetings to be held must be at the call of and under the chairmanship of full time government officials.

(4) Full and complete minutes of each meeting must be kept.

(5) The functions of such committees must be purely advisory and any determinations of action to be taken must be made solely by government representatives.

So long as the activities of an industry advisory committee are carried on within these limitations, they will not be an independent violation of the antitrust laws.[39] The Department of Justice retains complete freedom to institute proceedings if the plan is used to accomplish unlawful private ends.

H. G. Morison, Former Assistant Attorney General in charge of the Antitrust Division, stated that he thought there would be "substantial danger of violation of antitrust laws" if standards set out in the letter of October 19, 1950, were not observed.[40] Even though these points were complied with, participants could violate antitrust laws at such meetings. The rules of the National Production Authority applicable to industry advisory committees are less stringent than those set forth in the October 19, 1950, letter of Deputy Attorney General Ford. The N.P.A. regula-

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[38]Letter of Attorney General to Director of Office of Defense Mobilization (June 14, 1951).

[39]Letter of Deputy Attorney General Peyton Ford to executive departments (October 19, 1950).

[40]See note 15 *supra*, at 7.

tions, according to Morison, are inadequate in many respects. Compliance with these regulations would not automatically result in exemption from antitrust laws.

The Subcommittee on the Study of Monopoly Power uncovered considerable evidence indicative that procedures outlined by the Department of Justice in October of 1950 have not been adhered to by defense agencies in utilization of industry advisory committees and that such committees have frequently gone far afield in their activities. Regulations adopted for the conduct of such committees have been inadequate or have been carelessly followed. Many other questionable practices in the operation of such committees exist.[41] While nominally called for the purpose of giving advice to officials of the government, industry advisory committees have sometimes served as convenient vehicles for discussions by industry members of important competitive factors unrelated to the administrative function of the committee.

Minutes of industry advisory committees frequently state that agreement has been reached as to content of government regulations. In many instances, no doubt, it is meant that committee members agreed on recommendations. In some instances, however, it seems that the government has utilized these committees, not to obtain advice, but to get industry's consent to government regulations. The minutes of industry advisory committee meetings also indicate that agreement is sometimes reached outside of the official meetings. DiSalle indicated that settlements outside of meetings would not be in accord with government policy. In other instances proposals have been taken under advisement.[42]

The manner in which industry advisory committees operate, their functions, and their duties find no prescription in the Act. Various regulations have been promulgated by the defense departments. In addition the Department of Justice has frequently called attention to certain minimum standards to which, from an antitrust view, it is highly desirable that such committees adhere. The extent to which these guides have been followed is reflected by the March 15, 1951, letter of the Assistant Attorney General. Committees have met without the benefit of a government chairman; government representatives have lacked proper qualifications; agenda have been prepared and meetings have been called by industry rather than by the department or agency concerned; subcommittees, panels and other subgroups have not adhered to the requirements established for the full committees; the requirements with reference to committee representation set forth in Section 701(b)(ii) of the Defense Production Act

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[41] *Id.* at 29.
[42] *Id.* at 32, 33.

have not been met; and many of the committees, rather than being advisory, have in fact made decisions and exercised functions which properly should reside exclusively in government officials.

The minutes of such meetings were often obscure, ambiguous and incomplete. Morison stated that all advisory groups utilized by defense agencies must meet the requirements of D.P.A.

That any advisory committee should be permitted to hire private counsel either for legal services or other administrative functions creates a situation that the subcommittee feels is not in the public interest.[43] Industry advisory committees are selected to give the government the benefit of personal knowledge and experience and judgment of individual members. Hiring of counsel to synthesize or corrolate individual recommendations of members would defeat such personalized consideration. Furthermore, any provisions for compensation would tend to shift the primary allegiance of counsel from government to individuals who provide such remuneration. The subcommittee is of the opinion that when members of an industry advisory committee require legal aid, it is the obligation of the government to provide such assistance at government expense.

Business advisory committees, when properly conducted, perform a valuable function in advising and making recommendations to government officials. While business advisory groups can render valuable service, they may also serve as a basis for agreements among industry members which would result in violations of the antitrust laws.[44]

The principal statutory prerequisite of such committees is the requirement that they be representative as to size, location, affiliation, and industrial function. The most significant problem with respect to the formation of such committees is that of committee representation. The Act, Section 701, requires that in formation of such committees there be fair representation for independent small, medium and large business enterprises, for different geographical areas, for non-member as well as trade association members and for different segments of the industry. Such committees should reflect the point of view of each and every element of an industry if they are to contribute to the defense effort and also not serve to eliminate competition through discrimination.[45]

The D.P.A. permits the employment of "persons of outstanding experience and ability without compensation" as well as the employment of experts and consultants. Paid trade association executives have been

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[43] *Id.* at 42.
[44] See note 8 *supra*, at 30.
[45] *Id.* at 31.

present as members of industry advisory committees. Trade association executives have at times been chairmen of these committees. The statute requires that fair representation on these committees be given to companies members of trade associations but does not require representation for paid trade association executives. Michael DiSalle, Former Director of the Office of Price Stabilization, expressed preference for industry representatives instead of paid trade association executives. Manly Fleischmann, Former Administrator of the National Production Authority, also opposed the presence of full time employees of trade associations at meetings of industry advisory committees.

On June 6, 1951, then Deputy Attorney General Ford also expressed disapproval of participation of paid trade association executives in activities of industry advisory committees either as members or as observers. He said in the June letter summarizing the position of the Department of Justice:

> "In our view, if trade association executives are permitted to take part in industry advisory committee activities, either as members or observers, they may be in a position to create an atmosphere in which the interests of special groups, rather than those of public, would become paramount."

Morison, on the other hand, stated that he did not think because a man was a paid trade association executive that he should be automatically excluded but felt that since such a man represents an entire industry he would listen to the dominant element in that industry. He would, however, prefer a man from industry to one from a trade association.[46]

Congress in passing the Defense Production Act of 1950 has attempted to further production with the least possible adverse effect on competition. It is to be expected that some conflicts should arise, but on the whole the Act is going a long way toward carrying out the objectives of Congress and aiding mobilization with a minimum of undesirable concentration.

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[46]See note 15 *supra,* at 26.

RECENT DECISIONS

Bailment—Parking Lot Liability

Plaintiff parked his car in the defendant's parking lot, which was located near a baseball park. Defendant's custom with all cars was to direct the incoming cars to a particular location and direct drivers to lock their cars and retain the keys; plaintiff complied. When the plaintiff returned for his car he discovered that a glass had been broken and suitcases which were in the back seat of the car had been stolen. The plaintiff brought this action to recover the value of the suitcases and contents. Held: No bailment was established with reference to either the automobile or suitcases for lack of sufficient delivery of possession. Since there was no bailment, there was no duty arising from a bailor-bailee relationship and hence no liability. *Giles v. Meyers,* 107 N.E.2d 777 (Ohio Common Pleas, 1952).

In order to fix liability upon a proprietor of an automobile parking lot, it is generally necessary to ascertain whether there has been such a delivery of, or assumption of control over, the automobile entrusted to him as to create a bailment.[1] Generally, it would seem that a transaction whereby, in consideration of a small charge, a person who receives a ticket for a car and secures the privilege of parking it in a parking place enclosed by a fence, with an entrance and exit and an attendant on duty at all times, would impose upon the proprietor of such parking place the liability of bailee for hire.[2] On the other hand, it was held in Ex parte *Mobile Light & R.R.*[3] that where a car owner leaves his car in an outdoor parking place adjacent to a baseball field, the relationship is that of licensor-licensee and not one of bailment.

It has been held that where a car is driven by the owner to a parking lot and parked, without being delivered to any attendant or agent of the owner of such parking place, in the absence of express agreement no bailment is created.[4] This decision followed the rule that there can be no bailment without delivery of possession to the bailee.[5] But, in the case of *Galowitz v. Magner*[6] which is contrary to Ex parte *Mobile Light & R.R.,*[7] the court held that where the automobile is left in a lot specially designed for parking and the owner parked it himself and removed the keys, a bailment was created. This decision has been followed by several later cases.[8]

The mere classifying of the parking lot problem as a bailment, license, or lease does not in all cases automatically determine the rights and liabilities of the parties. Other matters are often taken into consideration, such as special contracts made between the car owner and the parking lot proprietor,[9] tickets issued by the proprietor of the lot limiting his liability, [10] or the problem of proving that the bailee has failed to exercise the necessary care.[11]

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[1]24 Am. Jur., Garages, Parking Stations & Liveries § 29.
[2]See Note, 34 A.L.R. 925, 926 (1924).
[3]211 Ala. 526, 101 So. 177 (1924).
[4]Suits v. Electric Park Amusement Co., 213 Mo. App. 275, 249 S.W. 656 (1923); Lord v. Okla. State Fair Ass'n, 95 Okla. 294, 219 Pac. 713 (1923).
[5]See note 1 *supra.*
[6]Galowitz v. Magner, 208 App. Div. 6, 203 N.Y.S. 421 (1924).
[7]See note 3 *supra.*
[8]Beetson v. Hollywood Athletic Club 109 Cal. App. 715, 293 Pac. 821 (1930); General Exchange Ins. Corp. v. Service Parking Grounds, 254 Mich. 1, 23 N.W. 898 (1931).
[9]Pennroyal Fair Ass'n v. Hite, 195 Ky. 732, 243 S.W. 1046 (1922); Chattanooga Interstate Fair Ass'n v. Benton, 5 Tenn. App. 480 (1927).
[10]Marine Ins. Co. of London v. Rehm, 177 So. 79 (La. App. 1937).
[11]Leonard Bros. v. Standifer, 65 S.W.2d 1112 (Tex. Civ. App. 1933).

The instant case is contrary to *Galowitz v. Magner*[12] and seems to follow the doctrine laid down by the Alabama court in Ex parte *Mobile Light & R.R.*[13] It is submitted that the subject case would have been more equitable if the Ohio court had chosen to follow the *Galowitz* case.[14]

Bill Templeton

Bills & Notes—Does Breach of a Concurrent Executory Contract Constitute Fraudulent Inducement to Execute?

Plaintiff brought an action against a buyer on five negotiable instruments in the form of trade acceptances drawn by a seller and endorsed and negotiated to the plaintiff after having been accepted by the buyer. The buyer attempted to avoid liability by alleging that the instruments were obtained by fraud, since the seller breached an oral executory contract made simultaneously with the execution and delivery of the trade acceptances. Held: The breach of an executory contract which induces the execution of a negotiable instrument is not sufficient to constitute fraud and render title to negotiable paper defective, unless it be directly and spcifically charged and clearly proven that the executory contract was made with the present undisclosd intention of not performing it. *Salitan v. Horn,* 55 So.2d 444 (Miss. 1952).

A binding executory promise may constitute a sufficient consideration for the execution of a negotiable instrument[1] and the promise may be to render services.[2] The fact that a negotiable instrument is given in consideration of an executory contract by the payee does not deprive the indorsee of his character as a holder in due course if he has no notice of a previous breach of said contract.[3] Every holder of a negotiable instrument is deemed prima facie to be a holder in due course;[4] but if the negotiator's title is defective, the holder must prove that he or some person under whom he claims acquired title as a holder in due course.[5]

Was the seller's title defective? A title is defective if the instrument is obtained by fraud.[6] Were the instruments in the instant case obtained by fraud? As a general rule fraud must be predicated on past or existing facts, or on alleged past or existing facts, and not on broken promises.[7] Fraud may be based on a broken promise when

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[12]See not 6 *supra.*

[13]See note 3 *supra.*

[14]See note 6 *supra.* "It seems to me obvious that plainttiff had the right to believe from the fact that defendant maintained an enclosed space for parking cars, with an entrance and exit and attendant, that he was paying the parking fee in consideration of care and watchfulness to prevent injury or loss. Otherwise he might almost as well have parked upon the public street and saved the fee."

[1]Jones v. Green, 173 Ark. 846, 293 S.W. 749 (1927); 10 C.J.S., Bills & Notes § 151(d).

[2]Newton v. Roberts, 36 Ga. App. 156, 136 S.E. 98 (1926); 10 C.J.S., Bills & Notes § 151(d).

[3]Drukker v. Howe & Haun Inv. Co., 136 Cal. App. 437, 29 P.2d 289 (1934); Smith v. Ellis, 142 Miss. 444, 107 So. 669 (1926).

[4]Miss. Code § 98 (1942); Sivley v. Williams, 112 Miss. 276, 72 So. 1008 (1916); Gillespie v. Planter's Oil Mill & Mfg. Co., 76 Miss. 406, 24 So. 900 (1899).

[5]Miss. Code § 98 (1942); Cassedy v. Wells, Jones, Wells & Lipscomb, 162 Miss. 102, 137 So. 472 (1931); Merchants' & Farmers' Bank v. Bank of Winona, 106 Miss. 471, 64 So. 210 (1914).

[6]Miss. Code § 96 (1942). Cassedy v. Wells, Jones, Wells & Lipscomb, *supra* note 5.

[7]McArthur v. Fillingame, 184 Miss. 869, 186 So. 828 (1939); see Note, 51 A.L.R. 49 *et seq.* & n. 7 (1927).

the payee making the promise has the present undisclosed intention of not performing it;[8] but the mere nonperformance of a promise is not in itself evidence establishing fraud or lack of intent to perform the contract.[9] The undisclosed intention of not performing an executory contract may be proved by circumstantial evidence[10] and from inferences drawn from proven facts.[11] In Mississippi fraud must be proved by a clear and satisfactory preponderance of the evidence as distinct from a mere preponderance of the evidence.[12] Whether there is an intent of nonperformance is a question for the jury.[13]

The mere breach of an executory contract is insufficient to establish fraud; and since the defendant did not prove that the promisor intended to breach the contract at the time it was made, the holder's prima facie case must prevail.

B. B. McClendon, Jr.

Contempt—Determination and Punishment by Accusing Judge After Verdict

On receiving the verdict in a trial of eleven communists the trial judge filed a certificate under Federal Rules of Criminal Procedure, Rule 42(a), finding the petitioners, attorneys for the defendants, guilty of criminal contempt and summarily imposed jail sentences up to six months. The Court of Appeals affirmed in part and reversed in part.[1] The United States Supreme Court granted certiorari to review the following question: Was the contempt, as and when certified, one which the accusing judge was authorized under Rule 42(a) to determine and punish himself; or was it one to be adjudged and punished under Rule 42(b) only by a judge other than the accusing one and after notice, hearing, and opportunity to defend? Held: Rule 42(a) was correctly applied. *Sacher v. United States,* 343 U.S. 1 (1952).

Rule 42, Federal Rules of Criminal Procedure,[2] provides two methods of handling cases of criminal contempt. Rule 42(a) was followed. Three dissenting justices thought Rule 42(b) should have been applied.[3]

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[8]McArthur v. Fillingame, *supra* note 7; Miss. Power Co. v. Bennett, 173 Miss. 109, 161 So. 301 (1935). See Note, 51 A.L.R. 63 *et seq.* & n. 14 (1927).

[9]McArthur v. Fillingame, *supra* note 7; Mid-Continent Life Ins. Co. v. Pendleton, 202 S.W. 769 (Tex. Civ. App. 1918); See Note, 51 A.L.R. 163 *et seq.* & n. 147 (1927).

[10]Snyder v. City Bond & Finance Co., 106 Cal. App. 745, 289 Pac. 859 (1930); See Note, 51 A.L.R. 166 (1927).

[11]Bouey v. Poterfield, 96 Cal. App. 674, 274 Pac. 766 (1929) (rehearing denied).

[12]Martin v. Gill, 182 Miss. 810, 181 So. 849 (1938); Thomas v. Rosenberg & Sons, 153 Miss. 314, 120 So. 732 (1929); 37 C.J.S., Fraud § 114 n. 64. Mississippi requires a greater amount of evidence in a fraud case than in an ordinary civil suit.

[13]Nelson v. Shelby Mfg. & Improvements Co., 96 Ala. 515, 11 So. 698 (1892); See Note 51 A.L.R. 169 & n. 165 (1927).

[1]U.S. v. Sacher, 182 F.2d 416 (2d Cir. 1950).

[2]Rule 41, Criminal Contempt: "(a) Summary Disposition; a criminal contempt may be punished summarily if the judge certifies that he saw or heard the conduct constituting the contempt and that it was committed in the actual presence of the court. The order of contempt shall recite the facts and shall be signed by the judge and entered of record. (b) Disposition upon Notice and Hearing. A criminal contempt except as provided in subdivision (a) of this rule shall be prosecuted on notice. The notice shall state the time and place of hearing, allowing a reasonable time for the preparation of the defence, and shall state the essential facts constituting the criminal contempt charged and describe it as such. . . . If the contempt charged involves disrespect to or criticism of the judge, that judge is disqualified from presiding at the trial or hearing except with the defendant's consent. . . ."

[3]Sacher v. U.S., 343 U.S. 1, 14 (1952), dissenting opinion of Justice Black.

Petitioners contended that the power of summary punishment expired by reason of two circumstances: (1) that the trial judge waited until the trial was completed to invoke the punishment, and (2) that he included in the certificate a charge that the contumacious instances were the result of an agreement between counsel, which if it existed, was not made in his presence.[4]

The power of a court to invoke summary punishment in cases of contempt committed in the presence of the court is a longstanding common law tradition.[5] The reason for this rule is to prevent disregard for the authority of the courts and obstruction of the trial process.[6]

The notes of the Advisory Committee of Rules in respect to Rule 42(a) indicate that the rule as stated is substantially a restatement of existing law,[7] citing Ex parte *Terry*[8] and *Cooke* v. *United States*.[9] In Ex parte *Terry* the Court stated that it was not necessary to determine whether the trial court would have had the power to summarily impose punishment for contempt without hearing if it had done so at a "subsequent term or a subsequent day of the same term." In the *Cooke* case the trial judge imposed summary punishment eleven days after the contumacious act, and the Supreme Court reversed and said that another judge should have been assigned to try the case upon remand.

It is a settled doctrine that in direct contempts committed in the face of the court, the offender may be instantly apprehended and imprisoned, without trial or issue.[10] Such power is considered essential to the protection of the courts in the discharge of their functions.[11]

The statutes which provide for punishment for contempt are Sections 401 and 402, Volume 18 of the United States Code. But there is no definite reference as to the timing of the punishment.

Three state courts have dealt with the problem of summary proceedings which were delayed until the end of the trial, two upholding the judge's summary power,[12] and one denying it.[13] Federal courts have handled the problem in accord with the instant case.[14]

It seems clear that the main case has extended the rule by not requiring instant punishment upon the occurrence of a contemptuous act. Whether this rule is extended to all trials is still in doubt since the majority indicated that was the opinion of the court that Rule 42(a) permits the trial judge to delay summary punishment until the end of the trial "if he believes the exigencies of the trial require that he defer judgment until its completion without extinguishing his power."[15]

Earl R. Cruthirds

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[4]*Id.* at 454.
[5]4 BL. COMM. *286.
[6]*Id.* at 283-5.
[7]FED. R. CRIM. 42 (Notes of Advisory Committee on Rules).
[8]128 U.S. 289 (1888).
[9]267 U.S. 517 (1925).
[10]*Ex parte* Terry *supra* note 8; 17 C.J.S. CONTEMPT § 71.
[11]*Ibid.*
[12]*In re* Cary, 165 Minn. 203, 206 N.W. 402 (1925); Middlebrook v. State, 43 Conn. 257 (1876).
[13]*In re* Foote, 76 Cal. 543, 18 Pac. 678 (1888).
[14]Hallihan v. U.S., 182 F.2d 880 (9th Cir. 1951), *cert. denied*, 341 U.S. 952 (1950) (where delay in imposition of punishment was overnight); McInnis v. U.S., 191 F.2d 157 (9th Cir. 1951), *cert. denied*, 342 U.S. 953 (1952).
[15]Sacher v. U.S., 343 U.S. 1, 11 (1952).

Constitutional Law—Non-Testimonial Self-Incriminatory Evidence and the Due Process Clause

Defendant was compelled to submit to a sobriety test, consisting of writing his name, walking a straight line, etc., and was later convicted of drunken driving, largely on evidence obtained from the test. Defendant appealed, asserting that the compulsory test violated (1) the self-incrimination prohibition of the Constitution of Delaware and (2) the due process clause of the Fourteenth Amendment to the Constitution of the United States. Held: Neither constitution was violated: (1) "The essence thereof is the freedom from *testimonial* compulsion," and (2) "It cannot be said . . . the sobriety test was repugnant to the decencies of civilized conduct which would thereby constitute a denial to him of due process of law under the Fourteenth Amendment." *Smith* v. *State,* 91 A.2d 188 (Del. 1952).

Although the argument was made that both constitutions were violated, that portion concerning the self-incrimination clause of the Delaware Constitution[1] is of only minor interest, as the court simply adopted what has become the distinctly majority view in recent years,[2] by limiting the application of the prohibition to testimonial self-incrimination. However, the contention of the defendant based upon the due process clause of the Fourteenth Amendment is of somewhat more consequence.

Shortly after the Civil War and the passage of the so-called "Civil War Amendments," the United States Supreme Court was urged to accept the theory that the Fourteenth Amendment made the entire Bill of Rights applicable to the states. However, the court rejected that view and found a dual citizenship, with some of the privileges of one not extending to the other.[3] In 1908 that Court held specifically that self-incrimination was not one of those guarantees of the Bill of Rights which were made applicable to the states by the Fourteenth Amendment.[4] Later the Court spoke again and announced the test as to which of the guarantees were so included to be those, "implicit in the concept of ordered liberty."[5] But neither this nor any other test disturbed the rule excluding the self-incrimination clause from the due process clause, as announced in the *Twining* case.[6] An escape was found from this situation in a recent case which declared that the due process clause was violated if evidence was obtained from the accused in such a manner as to "offend a sense of justice."[7]

The instant case was obviously an attempt by the defendant to bring himself within the escape which the *Rochin* case[8] had announced. His failure to do so provides the courts with an indication that methods which "offend a sense of justice" must at least be more offensive than the sobriety test employed by the Delaware State Police, though there is no indication by the Delaware Court as to what it would consider the limit to the *Rochin* escape to be.

James L. Young

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[1]"In all criminal prosecutions, the accused . . . shall not be compelled to give evidence against himself." Del. Const., Art. I, § 7.

[2]"The contention has met with little favor in recent decisions in the state courts, most of which have continued to draw the distinction . . . between real and verbal evidence." See Note, 25 A.L.R. 2d 1408 (1952).

[3]Slaughter House Cases, 16 Wall 36, 21 L. Ed. 394 (U.S., 1873).

[4]Twining v. N. J., 211 U.S. 78 (1908).

[5]Palko v. Connecticut, 302 U.S. 319 (1937).

[6]Twining v. New Jersey, *supra* note 4.

[7]Rochin v. California, 72 S. Ct. 205 (1952).

[8]*Ibid.*

CONSTITUTIONAL LAW—THE FIRST AMENDMENT AND MOTION PICTURE CENSORSHIP

In New York an Italian film, *The Miracle,* was denied license for exhibition under a statute[1] as being "sacrilegious." The United States Supreme Court held that motion pictures must be accorded the same constitutional protection as speech and the press, and that the prior restraint of the New York statute was not justifiable. *Burstyn, Inc. v. Wilson,* 343 U.S. 495 (1952).

In *Gelling v. Texas,*[2] immediately following this decision, the Court declared invalid an ordinance which prohibited movies "of such character as to be prejudicial to the best interests of the people."

In the subject case the Court overrules the decision in *Mutual Film Corp. v. Ohio*[3] to the extent that it denied constitutional protection to motion pictures.

The test then applied to invalidate the New York statute seems somewhat elusive.[4] To begin with, it is the Supreme Court's position that the word "sacrilegious" sets the censor "adrift upon a boundless sea amid a myriad of conflicting currents of religious views." Referring to the indefiniteness of the term, the Court continues that it ". . . is far from the kind of narrow exception to freedom of expression which a state *may carve out to satisfy the adverse demands of other interests of society.*" (Emphasis added.) Thus, the Court seems to engage in a balancing process reminiscent of earlier free speech cases,[5] which process it emphasizes further:

> ". . . it is enough to point out that the state has no legitimate interest in protecting any or all religions from views distasteful to them which is sufficient to justify prior restraint upon the expression of those views."

Clearly, the concurring opinion of Justices Jackson and Frankfurter in the *Burstyn* case invalidates the statute as unconstitutionally vague and offensive to Due Process. It must be observed that the *Gelling* case is a reversal based upon the

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[1]A board may refuse to license a film that is "obscene, indecent, immoral, inhuman, sacrilegious or is of such character that its exhibition would tend to corrupt morals or incite to crime." MCKINNEY'S N. Y. CONSOL. LAWS, c. 16, §§ 122, 129 (1947). It is only on the ground that the film here was "sacrilegious" that it was denied license.

[2]343 U.S. 960 (1952).

[3]236 U.S. 230 (1915).

[4]See discussions in Note, *The Supreme Court, 1951 Term,* 66 HARV. L. REV. 89 (1952), at 114-116; Comment, 1952 U. ILL. L. J. 439 (1952); Frank, *United States Supreme Court: 1951-52,* 20 U. OF CHI. L. REV. 1 (1952), at 29-31.

[5]*Cf.:* Near v. Minn. *ex rel.* Olsen, 283 U.S. 697, 722, where the Court struck down an injunction against defamatory charges against public officials: ". . . but the theory of the constitutional guaranty is that even a more serious public evil would be caused by authority to prevent publication." And in Chaplinsky v. New Hampshire, 315 U.S. 568 (1942), where a penal statute against "fighting words" was allowed: ". . . such utterances are no essential part of any exposition of ideas, and are of such slight social value . . . that any benefit that may be derived from them is clearly outweighed by the social interest in order and morality." See also U.S. v. Dennis, 341 U.S. 494 (1951), where the Court upheld provisions against advocacy of overthrowing the United States government, and said that reversals of convictions by the Court ". . . have been based on the fact that the interest which the state was attempting to protect was . . . too insubstantial to warrant restriction of speech," and the opinion of Judge Wiley in Ohio v. Smith (Toledo, Dhio, Municipal Court, 1952), quoted in 38 A.B.A.J. 1031 (1952): "To subject a newsreel to our present censorship is . . . a greater evil than the possibility of evil against which the statute was designed to protect."

authority of the subject case and *Winters v. New York*,[6] wherein a statute was struck down on the score of vagueness. Is the *vagueness* of the restraint, then, to be considered the criterion in the subject case, or is it rather the *nature of the restraint?*

The significance of the decision, of course, is that it brings motion pictures within the purview of the First Amendment; the obvious result is that many cities and states must re-examine their regulations relative to motion picture censorship in its various forms.[7] Attention must be called to the restraining language in all a penal measure against showing obscene pictures, not involving a censoring board. these cases.[8] *Ohio v. Smith*[9] examines an ordinance identical to the statute in the *Mutual* case and finds that it is now unconstitutional.

The Court has cautiously left the door ajar for censorship. Movies make a different impact upon society from written and spoken words and may therefore require different restraints, which must still be fitted into the mold of familiar words that have already attained "precision from the sense and experience of men."[10]

John White Valentine

Deposition—Statute Requiring Interested Deponent to Personally Attend Trial—Not Applicable to Non-resident

Plaintiff, a non-resident, sued a resident defendant. Depositions of the plaintiff were necessary to prove the case. Defendant, pursuant to statute,[1] made affidavit that in his opinion personal appearance of plaintiff as a witness was necessary to attain justice and moved that the depositions be stricken. The motion was denied by the lower court. Held: Affirmed. The statute does not apply to non-resident ligtigants or interested witnesses. *Milner Products Co. v. Salitan,* 61 So.2d 303 (Miss. 1952).

Depositions were not known to common law[2] and plaintiff contended that since the statute does not expressly exclude non-residents it should be construed to include

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[6]333 U.S. 507 (1948).

[7]In Anderson v. Hattiesburg, 131 Miss. 216, 94 So. 163 (1922), the Mississippi Supreme Court construes the statute corresponding to Miss. Code § 2286 (1942),

[8]The Supreme Court's paraphrase of the New York construction of the statute in Winters v. New York, *supra* note 6: ". . . the massing of stories of bloodshed and lust in such a way as to incite to crime against the person." In the *Mutual* case, the board should approve "only such films as are in the judgment and discretion of the board . . . of a moral, educational or amusing and harmless character." These words were definite enough to delegate authority to the board in absence of First Amendment considerations.

[9]See note 5 *supra.*

[10]Language in the *Mutual* case quoted in Justice Frankfurter's concurring opinion in the subject case.

[1]Miss. Code § 1711 (1942). "When the deposition of a party or other interested witness has been taken in a cause, and a party to such cause shall make and file an affidavit, ten days before the time of trial, if such deposition shall be then on file, that, in his opinion, the oral examination in open court of such person is necessary to the attainment of justice, the deposition shall not be admitted in evidence for the party taking it if such person be alive at the time of trial and not unable to attend court on account of disability from permanent sickness, physical injury, or from weakness and disability incident to old age; but such person may be examined in open court. Where such deposition shall be filed in the clerk's office within ten days of the time of hearing the case, the affidavit required may be made at any time before the trial. Any party or witness thus required to attend shall be entitled to compensation as any other witness."

[2]4 Jones, Evidence § 1911 (2d ed. 1926); People v. Turner, 265 Ill. 594, 107 N.E. 162 (1922).

them.[3] Our court has liberally construed a companion statute[4] by holding it inapplicable to witnesses who reside outside the state.[5]

A few states do not allow deposition to be taken from non-residents[6] but this is not true in Mississippi.[7] The court reasons that it was not the intent of the legislature to include non-residents in the statute construed, since to do so would have the practical effect of preventing, in many instances, non-resident litigants from bringing action in the state to enforce their rights because of the expense involved in making personal appearances.

Defendant in the subject case contended that he was denied the right to have the witnesses personally appear before the court and jury. In opposition to that contention, it is well established that such right ceases if the witnesses are unobtainable.[8] A suggested argument is that defendant could not cross-examine the deponents face to face without undue expense in employing an attorney in another jurisdiction or in time and travel. This position, too, has been discountenanced by substantial authority.[9] Further, defendant had an opportunity to cross-examine deponents by written interrogatories.[10]

In reaching its decision the court concluded that the phrase, "any party or witness thus required to attend shall be entitled to compensation as any other witness," rendered the statute inapplicable to non-residents, because they could not be subpoenaed and could not be paid for mileage except that traveled within the state.[11]

In the writer's opinion, the result reached by the court is highly desirable, and as to the court's position on the undue expense point, it is submitted that while not to the same degree, a similar difficulty may be faced where resident litigants or interested witness reside at such great distances from the place of trial that the expenditure in making personal appearance would be greater than the financial benefit derived from a favorable verdict.

G. F. Dabbs, Jr.

Domestic Relations—Right of Wife to Sue Husband's Employer in Tort

Plaintiff sued to recover damages for personal injuries caused by the negligence of her husband, defendant's employee, while in the course of his employment. Defendant employer filed a motion to dismiss on the sole ground that since the wife was barred from suing her husband, she is barred from suing her husband's employer.

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[3]Levy v. Kirby, 8 Harr. 344, 192 Atl. 696 (Del. 1937); O'Neil v. Cooles, 33 Del. 541, 140 Atl. 648 (1928); *In re* Judges' Estate, 282 Mich. 48, 275 N.W. 726 (1937) (all support plaintiff's contention).

[4]Miss. Code § 1708 (1942) provides that when deposition is taken from any witness, the party against whom the witness was examined may procure the witness at the trial and put him on the stand.

[5]Fidelity & Casualty Co. v. Johnson, 72 Miss. 333, 17 So. 2 (1894).

[6]Tanous v. Johnston, 113 Ore. 343, 232 P. 793 (1925); Baker v. People, 72 Colo. 68, 209 P. 791 (1922).

[7]Miss. Code § 1703 (1942).

[8]See note 4 *supra;* 3 Wigmore, Evidence § 1397 (3d ed. 1940); Minder v. Georgia, 183 U.S. 559 (1902); Baker v. People, *supra* note 6; State v. Pagels, 92 Mo. 300, 4 S.W. 931 (1887).

[9]Advertisers Exchange v. Bleich, 57 N.E.2d 91 (Ohio 1943).

[10]Miss. Code § 1712 (1942).

[11]*Id.* § 3953.

HELD: The plaintiff stated a cause of action and should be allowed to recover. *Tallios* v. *Tallios,* 345 Ill. App. 387, 103 N.E.2d 597 (1952).

There has been considerable diversity of opinion concerning the wife's right of action against her husband's employer for injury committed by the husband while in the course of his employment.[1] The objections to allowing such a suit as the present case have been met and refuted, as may be seen by the case of *Schubert v. Schubert Wagon Co.*,[2] where the employer was held liable for injuries to the wife of the employee.

The common law rule stated that a wife could not maintain an action aganst her husband.[3] It is a mooted point whether this disability was due to lack of substance[4] or lack of remedy only.[5] This objection is refuted by showing that the marital immunity of the spouse does not mean that there is no right of action but merely denies the remedy against the spouse and does not destroy the right of action against the employer.[6]

Courts denying liability of the employer have stated such liability is based on the maxim *respondent superior;* the master's liability was derivative from that of the servant.[7] This view is not sound, as the recognition of an independent duty owing by the employer to the person injured is founded on the wrongdoing,[8] not on the liability of the employee. Vicarious liability is imposed because of expediency and social justice; it is not the result of legalistic logic.[9] The liability of the employer is primary, not secondary or derivative, as he who acts through an agent acts himself, and both master and servant are primarily liable.[10]

Further, there has been the objection that to allow such a suit would result in circuity of action, thus disrupting marital relations.[11] However, the likelihood of circuity of action is small since under modern statutes the wife's property is not subject to her husband's debt.[12] The employer may not hide behind the husband's

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[1]Those holding employer liable: Broaddus v. Wilkenson, 281 Ky. 601, 136 S.W.2d 1052 (1940); Hudson v. Gas Consumer's Ass'n, 123 N.J.L. 252, 8 A.2d 337 (1939); Klinger v. Steffens, 17 N.J. Mis. R. 118, 6 A.2d 217 (1939). *Contra:* Riegger v. Bruton Brewing Co., 178 Md. 518, 16 A.2d 99 (1940); Myers v. Tranquility Irrig. Dist., 26 Cal. App.2d 385, 79 P.2d 419 (1938); Emerson v. Western Seed Co., 116 Neb. 180, 216 N.W. 297 (1927).

[2]249 N.Y. 253, 164 N.E. 42 (1928).

[3]Phillips v. Barnet, L.R. 1 Q.B. 436 (1876); For a general discussion, see 1 BL. COMM. *442.

[4]Dawson v. Dawson, 224 Ala. 13, 138 So. 414 (1931) (applying law of Mississippi and no recovery allowed); Note, 44 HARV. L. REV. 1138 (1931).

[5]Bennet v. Bennet, 116 N.Y. 584, 23 N.E. 17 (1889). "It is clear therefore, that at common law the right of action for a tort committed upon a married woman belonged to her. . . . She had a right of action for any actionable injury before but she could not set the law in motion unless her husband joined."

[6]McLaurin v. McLaurin Furniture Co., 166 Miss. 180, 146 So. 877 (1933). It would seem that the courts of Mississippi will hold the employer liable by virtue of this case.

[7]Davison v. Diamond Match Co., 10 Cal. App.2d 218, 51 P.2d 452 (1935); Pangburn v. Buick Motor Co., 211 N.Y. 228, 105 N.E. 423 (1914).

[8]See note 6 *supra,* at 190.

[9]Laski, *Basis of Vicarious Liability,* 26 YALE L. J. 105 (1916).

[10]McLaurin v. McLaurin Furniture Co., *supra* note 6; Schubert v. Schubert Wagon Co., *supra* note 2; Broaddus v. Wilkenson, *supra* note 1.

[11]Emerson v. Western Seed Co., *supra* note 1.

[12]MISS. CODE § 451 (1942), the so-called "married women statutes."

personal immunity, which is based on the policy of preserving family peace,[13] because there is no policy to be served by extending its protection to him.[14]

It is submitted that the principal case reflects the modern trend toward judicial liberality in actions involving husband and wife.

Wm. Emmett Marston

Future Interests—Ascertaining Heirs-at-law of Testatrix at Death of Testatrix or at Termination of Life Estates

The settlor, a married woman seventy-one years of age, created an inter vivos trust in which the benefits were to be paid to her for her life, then to her husband for his life and upon the death of both the settlor and her husband, and then for life to the settlor's son, who was her only child, with remainder upon death of surviving life beneficiary to the then living issue of the son or, should he die without issue, to the heirs-at-law of settlor. On the same day the settlor executed her will in which she bequeathed the residuary estate subject to the terms of the trust agreement. The son survived both prior life tenants, and by his last will and testament he left the residuary estate to one other than was designated by the settlor. A bill was filed by the trustee seeking instructions. Held: The heirs-at-law of the settlor must be determined as of the death of the last life beneficiary, thereby excluding the son and his residuary legatee. *Delaware Trust Co. v. Delaware Trust Co.*, 91 A.2d 44 (Del. 1952).

The general rule in Delaware and in many other jurisdictions in the United States is that a gift over of the corpus of a trust to the heirs-at-law of the settlor after one or more life estates will go to those heirs living at the death of the settlor and not those living at the termination of the life estates.[1] The courts have looked with favor upon this rule since they feel that by applying it the words of description are given their natural and prima facie meaning.[2] The heirs-at-law of a testator are usually those persons who take inheritable real property immediately on the death of the owner if he dies intestate.[3] Courts favor the vesting of an estate at the earliest opportunity[4] in the testator's heirs or next of kin rather than some stranger;[5] consequently, the majority of courts have, in the absence of an intention to the contrary by the testator, allowed those who were heirs of the

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[13]Restatement, Agency § 217, comment *b* (1933).

[14]Schubert v. Schubert Wagon Co., *supra* note 2.

[1]Costello v. Costello, 149 F.2d 379 (D.C. Cir. 1945); New Britain Nat'l Bank v. Parsons, 118 Conn. 167, 171 Atl. 1 (1934); Hull v. Adams, 399 Ill. 347, 77 N.E.2d 706 (1948); Bagley v. Kuhn, 322 Mass. 372, 77 N.E.2d 312 (1948); Loring v. Sargent, 319 Mass. 127, 64 N.E.2d 446 (1946); Old Colony Trust Co. v. Johnson, 314 Mass. 703, 51 N.E.2d 456 (1943).

[2]Blanford v. Trust Co. of Norfolk, 294 Ill. 557, 128 N.E. 641 (1925); Brian v. Tylor, 129 Md. 145, 98 Atl. 532 (1916); State Street Trust Co. v. Sampson, 228 Mass. 411, 117 N.E. 832 (1917).

[3]White v. Fowler, 245 Ala. 209, 16 So.2d 399 (1944); Tyler v. City Bank Farmers' Trust Co., 314 Mass. 528, 50 N.E.2d 778 (1943); Heard v. Read, 169 Mass. 216, 47 N.E. 778 (1897).

[4]White v. Fowler, *supra* note 3; New Britain Nat'l Bank v. Parsons, *supra* note 1; Schlater v. Lee, 117 Miss. 701, 78 So. 700 (1918).

[5]Campbell v. St. Joseph's Industrial School, 53 A.2d 768 (Del. 1947); *In re* Nass's Estate, 320 Pa. 380, 182 Atl. 401 (1936); *In re* Swann's Estate, 147 Pa. St. 383, 23 Atl. 599 (1892).

testator at his death to take. A contrary result has been provided for by statute in some states.[6]

This general rule is applicable whether or not the limitation over is an executory devise or contingent remainder,[7] and it is immaterial whether the subject of the gift be personalty of realty.[8]

Such a rule is not one of substantive law but rather it is a rule of interpretation and is adopted by these courts in order that the intention of the testator, as expressed in his will, might be carried out.[9]

The minority rule as followed by some courts indicates that if it can be shown that the testator, by clear and unambiguous language,[10] intended that his heirs-at-law were to be determined at the termination of the life estates or at some other time subsequent to his death, then the duty devolves upon the courts to give effect to the legal consequences of such intention.[11] Such an intended result can be ascertained by searching the four corners of the instrument[12] and giving the words used therein their common and ordinary meaning instead of attaching some "legal" definition to them.[13]

The court in the subject case, in ascertaining the intention of the testator and interpreting the instrument so that his wishes might be executed, applied the minority rule to reach its decision.

Jesse D. Puckett

Inheritance—May Adopted Child Inherit from the Kindred of Its Adopting Parents?

An action was brought by an adotped child wherein the question was whether or not she could inherit through her adopting parent from a sister of said adopting parent, the adopting parent having pre-deceased the sister. Held: In view of the provisions of the adoption decree she could not inherit. *Reeves v. Lowe,* 56 So.2d 475 (Miss. 1952).

According to the great weight of authority, an adopted child has no right of inheritance through its adopted parents.[1] Although the adopting parents have a right to bind themselves to make the adopted child their heir, they do not have such a right to bind others.[2] Or stated another way—by adoption, the adopters can make

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[6]*In re* Bonsall's Estate, 288 Pa. 39, 135 Atl. 724 (1927).
[7]Crean's Estate, 61 Pa. 111 (1869).
[8]Kellett v. Shepard, 139 Ill. 443, 28 N.E. 751 (1891).
[9]Costello v. Costello, *supra* note 1; Jones v. Petrie, 156 Kan. 241, 132 P.2d 396 (1943); Lemmon v. Wilson, 204 S.C. 50, 28 S.E.2d 792 (1944).
[10]Tate v. Tate, 160 Ga. 449, 128 S.E. 393 (1925).
[11]Curriden v. Chandler, 79 N.H. 269, 108 Atl. 296 (1919); *In re* Field's Trust, 302 N.Y. 262, 97 N.E.2d 896 (1951); Farmers' Loan and Trust Co. v. Callan, 246 N.Y. 481, 159 N.E. 405 (1927).
[12]Jones v. Petrie, *supra* note 9; Lemmon v. Wilson, *supra* note 9.
[13]Campbell v. St. Joseph's Industrial School, *supra* note 5; Farmers' Loan and Trust Co. v. Callan, *supra* note 11.
[1]Shoemaker v. Newman, 65 F. 2d 208 (App. D.C. 1933); Wallace v. Noland, 246 Ill. 535, 92 N.E. 956 (1910).
[2]Merritt v. Morton, 143 Ky. 133, 136 S.W. 133 (1911).

for themselves an heir, but they cannot thus make one for their kindred.[3] However, substantial authority to the contrary does exist.[4]

The difference of opinion occurs in those cases involving the question of the effect to be given to statutes that are very general in nature and that provide simply, as does the Mississippi statute[5] on this question, that the chancery court has the power to grant adoption.

The reason for the rule seems to be that the statute does not permit[6] the adopting parents to create heirs for third persons.[7] Also, the ancestors of the adopting parent are presumed to know their relatives by blood and to have them in mind in the distribution of their estates, either by will or descent, but they cannot be expected to keep informed as to adoption proceedings in the probate courts of the counties of the state; and to allow an adopted child to inherit from the ancestors of the adopter would often put property into the hands of unheard-of adopted children, contrary to the wishes and expectations of such ancestors.[8] Conversely, ancestors have the same right to protect themselves against the effects of an adoption as they would have in the case of the creation of an heir by natural birth. That is to say, the ancestors could have disinherited the adopted child by making a will with the same effect as they could have disinherited the natural child.

Under the Mississippi statute[9] the adopting parent may adopt the child fully and completely, or may adopt the child and limit its rights by a decree of the court. In other words, the parent can either adopt partially or totally, conferring or withholding benefits at his option, but if he wishes to confer upon the child full benefits as though it were a natural child, there is nothing to prevent his so doing.[10] Therefore, the Mississippi courts have added to the rule that the adopted child acquires no right of heirship from the adopting parents the words, "when the petition and decree of adoption do not vest such right."[11]

One issue that usually arises in cases of this type is the argument that the adopted child inherits by virtue of the fact that she is the daughter of the adopting parents and not by virtue of the fact that she is a blood relation of any sort of the kindred. But it has been held that adopted children, for other purposes than inheritance from the adopting parents, are unlike children by birth[12] and, although

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[3]Warren v. Prescott, 84 Me. 483, 24 Atl. 948 (1892); Van Derlyn v. Mack, 137 Mich. 146, 100 N.W. 278 (1904); Hockaday v. Lynn, 200 Mo. 456, 98 S.W. 585 (1906); Phillips v. McConica, 59 Ohio St. 1, 51 N.E. 445 (1898); Smith's Estate, 225 Pa. 630, 74 Atl. 622 (1909); Batcheller-Durkee v. Batcheller, 39 R.I. 45, 97 Atl. 378 (1916); Helms v. Elliott, 89 Tenn. 446, 14 S.W. 930 (1890).

[4]Shick v. Howe, 137 Iowa 249, 114 N.W. 916 (1908); Riley v. Day, 88 Kan. 503, 129 Pac. 524 (1913); Anderson v. French, 77 N.H. 509, 93 Atl. 1042 (1915); *Re* Cryan, 301 Pa. 386, 152 Atl. 675 (1930).

[5]Miss. Code § 1269 (1942).

[6]*Quare:* Is it the statute that does not permit or the court's interpretation of the statute?

[7]*In re* Hall's Estate, 252 N.Y.S. 592, 141 Misc. 169, *decree aff'd*, 254 N.Y.S. 564, 234 App.Div. 151, and *order aff'd*, 259 N.Y. 637, 182 N.E. 214 (1932).

[8]Phillips v. McConica, *supra* note 3.

[9]See note 5 *supra*.

[10]Fisher v. Browning, 107 Miss. 729, 66 So. 132 (1914).

[11]Beaver v. Crump, 76 Miss. 34, 23 So. 432 (1898); Fisher v. Browning, *supra* note 10; Leonard v. H. Weston Lbr. Co., 107 Miss. 345, 65 So. 459 (1914); Whitman v. Whitman, 206 Miss. 838, 41 So.2d 22 (1949).

[12]Wallace v. Noland, *supra* note 1; Puterbaugh's Estate, 261 Pa. 235, 104 Atl. 601 (1918).

they inherit from the adopting parents, they do not so inherit from the adopting parents' kindred.

The decision in the *Reeves* case is based upon the fact that the decree of adoption did not specifically grant the right to the adopted child to inherit from the sister of her adopting mother. However, it appears that the underlying principle employed was that adopted children do not acquire the right of inheritance simply by virtue of the fact that they are adopted and thereby assume the *status* of a natural child born in lawful wedlock.[13]

This case is noteworthy mainly because the question has not heretofore been decided in this state, and because it brings Mississippi within that group of jurisdictions which recognize natural justice entirely consistent with sound judicial construction.

Frank W. Alexander

Insurance—Revealing Coverage to the Jury

Plaintiff sued three defendants for injuries. Plaintiff's brother, being examined by counsel for one defendant, revealed that one of the defendants might be insured but did not show which one. Held: Revealing the coverage was not reversible error. *Lancaster v. Lancaster,* 56 So.2d 302 (Miss. 1952).

Probably the earliest Mississippi case on revealing insurance coverage to a jury was *Herrin Lambert & Co. v. Daly.*[1] The Supreme Court ordered a new trial, saying the information could throw no light on the issue, and "could have no other tendency than to seduce a verdict on the ground that an insurance company and not the defendants would pay."[2]

In some cases disclosure of coverage has been held not to be reversible error.[3] In one case the good faith of counsel asking the question was used as the basis for determining whether or not a mistrial would be ruled.[4] In another the Court said: " . . . we must look to the effect of what was done rather than to the purpose with which it was done."[5]

The only cases which resulted in new trials, other than the *Herrin* case,[6] were two in which jurors themselves revealed that insurance might be involved.[7]

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[13]*Quare:* Could not the interpretation have been that the adoption decree merely limits the benefits conferred rather than enumerates them?

[1]80 Miss. 340, 31 So. 790 (1902).

[2]80 Miss. 340, 342, 31 So. 790, 791 (1902).

[3]Savery v. Gray, 51 So.2d 922 (Miss. 1951), and Williams v. Larkin, 166 Miss. 837, 147 So. 337 (1933), where coverage was brought but no evidence showed the jury that the defendant was insured; Peterman v. Gray, 210 Miss. 438, 49 So.2d 828 (1950), and Allen v. Friedmann, 156 Miss. 77, 125 So. 539 (1939), where the defendant himself showed he was insured; Pan-American Petroleum Corp. v. Pate, 157 Miss. 822, 126 So. 480 (1930), *sug. of error overruled,* and Finkbine Lbr. Co. v. Cunningham, 101 Miss. 292, 57 So. 916 (1911), where, to show a relationship of master and servant, it was brought out that the defendant carried insurance on the employees of an alleged independent contractor; and the subject case. On the other hand, it appears that the defendant is not allowed to show that he is not insured and must bear the burden of the verdict. Avent v. Tucker, 188 Miss. 207, 194 So. 596 (1940).

[4]Miss. Ice Utilities Co. v. Pearce, 161 Miss. 252, 134 So. 164 (1931).

[5]Robertshaw Trustees v. Columbus & G. Ry., 185 Miss. 717, 188 So. 308 (1939).

[6]See note 1 *supra.*

[7]Walley v. Williams, 201 Miss. 84, 28 So.2d 579 (1947); Odom v. Walker, 193 Miss. 862, 11 So.2d 452 (1943).

The Court in *M & A Motor Freight Lines, Inc., v. Villere*[8] considered the error to be corrected by an instruction to the jury to ignore what had been said. In *Robertshaw Trustees v. Columbus & G. Ry. Co.*[9] the evidence was excluded.

Our Court has held, however, that it is not reversible error to ask a juror, when questioning him on voir dire examination, if he has any interest in an insurance company.[10] But it has suggested a way to avoid it.[11] In a 1941 case, a plaintiff's attorney asked only the last two jurors if they or their families were connected with a liability insurance company. A motion for mistrial was overruled, and the Supreme Court affirmed. But Chief Justice McGehee, who with two others dissented, said he failed to see why this was not prejudicial if disclosure of coverage from a witness would be. The dissent further expressed a belief that there was perhaps a lack of good faith in waiting to ask only the last two jurors.[12]

The *Villere* case points out that *Yazoo City v. Loggins* made good faith of counsel the controlling consideration, while *Avery v. Collins* placed emphasis on the prejudicial effect of the disclosure of coverage.

The subject case seems to hold that there is no rule to be followed, but that each case is to be decided on its own merits. It does not say whether good faith or effect will control. It is submitted that effect should be the primary consideration. But good faith of the interrogator should also influence the judge's decision. Why should not both apply?

It is further submitted that Chief Justice McGehee's opinion is the better view, and that the method of examination suggested in the *Avery* case should be the required procedure. Revealing coverage upon witness examination or upon voir dire examination should be error unless it comes within an exception mentioned above.[13]

Arthur G. Murphey, Jr.

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[8]190 Miss. 848, 1 So.2d 788 (1941), where a photographer, sent to take pictures of an accident, testified that an insurance company had called him to do so.

[9]See note 5 *supra.* The Supreme Court said the only thing more the court could have done was to grant a new trial, and this was not asked.

[10]Kennedy v. Little, 191 Miss. 73, 2 So.2d 163 (1941), *sug. of error overruled;* Avery v. Collins, 171 Miss. 636, 157 So. 695 (1934); Lee County Gin Co. v. Middlebrooks, 161 Miss. 422, 137 So. 108 (1931); Yazoo City v. Loggins, 145 Miss. 793, 110 So. 833 (1926).

[11]Counsel should ask what businesses the juror has interests in, not if he has any interest in the insurance business. Nevertheless, if it is essential to test the juror's qualifications only by asking questions which will show that the defendant is insured, it is error for the judge not to admonish the jury that insurance shall have nothing to do with the case. Avery v. Collins, *supra* note 10.

[12]Kennedy v. Little, *supra* note 10.

[13]This comment is intended to cover only the Mississippi cases on the subject. An excellent summary of the law in the United States is found in the American Law Reports. On witnesses' revealing coverage, see annotations in 4 A.L.R.2d 816, 105 A.L.R. 1336, 95 A.L.R. 414, 74 A.L.R. 870, and 56 A.L.R. 1522. On the same problem on voir dire examination, see annotations in 4 A.L.R.2d 792, 105 A.L.R. 1330, 95 A.L.R. 404, 74 A.L.R. 860, 56 A.L.R. 1454.

Jurisdiction—Constitutionality of the Mississippi Youth Court Act

Appellant, seventeen years of age, was convicted of a felony in circuit court and appealed from a decree denying his petition for a writ of habeas corpus.[1] The appeal challenged the circuit court's jurisdiction of the matter. Held: The circuit court was without jurisdiction in the cause and the act[2] vesting exclusive, original jurisdiction of such matters in the youth court was a constitutional exercise of the police powers of the state. *Wheeler v. Shoemake, Sheriff,* 57 So.2d 267 (Miss. 1952).

Decison of the subject case required a determination of whether Sections 3 and 15 of the Youth Court Act of 1946,[3] which vest exclusive, original jurisdiction in all proceedings concerning any delinquent or neglected child under eighteen years of age in the youth court division of the chancery court, or where there is a county court, in the youth court division of the county court, are valid, or whether they are in conflict with, and void as violative of, that section of the Mississippi Constitution which provides that "the circuit court shall have original jurisdiction in all matters civil and criminal in this state not vested by this Constitution in some other court, and such appellate jurisdiction as shall be prescribed by law."[4]

In holding the Act valid the Court stated that "the act represents a legitimate exercise of the police power of the State."[5] The majority opinion sets forth an analysis of Mississippi juvenile court statutes and cites cases construing and upholding the validity of acts of 1916[6] and 1940.[7]

The state, appellee, argued that appellant was charged with a criminal matter and a felony, that original jurisdiction over such felonies is vested in the circuit court[8] and that the legislature cannot make a felony a civil action simply by statutory enactment. This contention was disapproved by the Court in its holding that "Appellant can not be charged for a crime in a criminal prosecution, but must be proceeded against in the Youth Court in a civil matter, not known at common law, and, therefore, not within the restrictions of Constitution Sec. 156."[9] The original jurisdiction in "civil" matters conferred on the circuit court is confined to matters which were of a common law nature, that is, to matters which were known at common law.[10] "Matters civil"[11] does not comprehend matters involving the youth

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[1]Habeas corpus will lie to attack a judgment for want of jurisdiction. Maddox v. Bush, 191 Miss. 648, 4 So.2d 302 (1941).

[2]Miss. Laws 1946, c. 207.

[3]*Ibid.*

[4]Miss. Const., Art. VI, § 156.

[5]Wheeler v. Shoemake, Sheriff, 57 So.2d 267, 279 (Miss. 1952).

[6]Miss. Laws 1916, c. 111; Hemingway's Code §§ 5697-5721 (1927); Miss. Code Ann. §§ 7247 *et seq.* (1930); Miss. Code §§ 6744-6763 (1942), *repealed by* Miss. Laws 1946, c. 207 and Miss. Laws 1948, c. 429, § 12.

[7]Miss. Laws 1940, c. 300; Miss. Code §§ 7185-7213 (1942), *repealed by* Miss. Laws 1946, c. 207, § 27.

[8]By virtue of Miss. Const., *supra* note 4.

[9]See note 5 *supra.*

[10]Bell v. City of West Point, 51 Miss. 262 (1875).

[11]Quoted words from Miss. Const. Art. VI, § 156.

court which were not known at common law.[12] Section 8 of the Youth Court Act expressly provides that matters involving the Youth Court Act are civil and not criminal.

By its determination that matters over which the youth court has exclusive, original jurisdiction are not "criminal," but are "civil" matters,[13] the majority opinion appears to be correct[14] and to better serve the minors' interests, as well as the state's substantial interests in their welfare.

George G. Currie

Oil and Gas Apportionment of Royalties Among Adjoining Landowners

Appellees are the owners of a 90 acre parcel of land which, with an adjoining 160 acre parcel, composes a 250 acre tract under a mineral lease. The assignees of the mineral leases obtained a permit from the State Oil and Gas Board to drill on the 250 acres and placed a well on the 160 acre tract. The entire 250 acres had been merged as one drilling unit and the allowable for this well was based accordingly upon 250 acres. All royalties from gas produced by the well have been paid to the owners of the 160 acres and this suit was brought by the owners of the 90 acres to recover a proportionate share of such royalties. Held: The owners of the 90 acre tract are entitled to recover. Suggestion or error overruled. *Griffith v. Gulf Refining Co.*, 61 So.2d 306 (Miss. 1952).

Under the rule of capture, adjoining landowners may not recover for non-negligent drainage of oil and gas from an adjoining tract. Such denial is based upon two theories: first, that the adjoining owners have the right to drill off-set wells;[1] and second, the title to the oil is lost when it flows beyond the property line.[2]

In an effort to prevent waste and conserve oil and gas resources, many state legislatures have enacted statutes for the purpose of controlling their production.[3] In 1919 a well-spacing regulation known as Rule 37 was adopted by the Railroad Commission, the regulating body of Texas.[4] Oklahoma's pooling statute[5] establishes spacing units and apportionment of royalties by adjoining owners. The constitutionality of this act was tested and upheld in *Patterson v. Stanolind Oil and Gas*

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[12]A notable exception to the youth court's jurisdiction is made by Paragraph (c) of Section 2 of Miss. Laws 1946, c. 207, which provides that if the child is thirteen years of age or older "the circuit court shall have exclusive jurisdiction . . . if he be charged with any crime which upon conviction is punishable by life imprisonment or death." Thus, the only criminal cases where the circuit court will continue to have original jurisdiction, when the accused is between thirteen and eighteen years of age, are murder and rape.

[13]Bell v. City of West Point, *supra* note 10.

[14]The dissenting opinion relies primarily for its interpretation of Section 156, *supra* note 4, on Montross v. State, 61 Miss. 429 (1883), which held invalid a legislative act which undertook to transfer the circuit court's jurisdiction of "crimes" committed in the town of Biloxi to another court.

[1]Stephens County v. Mid-Kansas Co., 113 Tex. 160, 254 S.W. 290 (1923).

[2]Grayburg Oil Co. v. Texas, 50 S.W.2d 355 (Tex. Civ. App. 1932).

[3]The landmark case which initiated the idea of compulsory pooling was Marrs v. City of Oxford, 32 F.2d 134 (8th Cir. 1929), wherein a city ordinance was upheld as constitutional which limited wells to one per block and royalty was distributed among owners in proportion to footage owned by them.

[4]Tex. Stat. (Vernon, 1936) art. 6029.

[5]52 Okla. Stat. §§ 81-279 (1941).

Co.[6] The Louisiana law,[7] declared constitutional by the state supreme court,[8] provides for voluntary pooling, and, in the absence of such, the Conservation Commission may require it. The Mississippi statutes[9] set up well-spacing regulations, provide for compulsory pooling, and empower the State Oil and Gas Board to grant permits for drilling and fix allowables.

The rule of non-apportionment is the settled law in Texas today.[10] It has been held that damages for drainage are recoverable where there is an express apportionment clause in the conveyance[11] or where there is a violation of the rules of the Railroad Commission in the drilling operations.[12] There is no apportionment even where acreage of one parcel is applied to satisfy the spacing and allowable requirement of the Railroad Commission.[13] It has been said that where such is done the Commission must have intended to permit the owner to produce a fair proportion of oil naturally flowing under his land and, in the same opinion, the court refused to discard the law of capture in Texas.[14]

In Section 10, Chapter 256 of the Laws of 1948, apportionment is required in Mississippi under circumstances such as existed in the subject case. By its decision, the Mississippi Supreme Court overruled expressly the rule of capture. The contention of the appellants that to apportion the royalties would deprive the owner of the 160 acre tract of its rights is unfounded when it is remembered that the well is producing under an allowable covering the entire 250 acres.

Betty Long

Reformation—Right of an Intervening Judgment Creditor

Darwin Scott owned two adjoining lots in Catlettsburg, one being vacant and the other having an apartment building on it. In 1946 Darwin's wife, Mildred, sued him for divorce, and in the property agreement Darwin agreed to convey to her the lot on which the apartment building was located. The conveyancer conveyed the vacant lot without anyone noticing the mistake. In 1948 Darwin borrowed money from the Eastern Kentucky Production Credit Association, giving them a promissory note secured by a chattel mortgage on certain livestock. In the meantime, Mildred had listed the above apartment building as her property, paid taxes on it, made minor repairs, and received the rent from the tenants. Darwin failed to pay the note and in the foreclosure suit the credit association obtained a general order of attachment which was levied on certain real estate, including the lot on which the apartment house was located. Mildred intervened, tendering a quit-

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[6]182 Okla. 155, 77 P.2d 83 (1938).
[7]Act No. 157 of 1940, §§ 8-9.
[8]Hunter Co. v. McHugh, 202 La. 97, 11 So.2d 495 (1942).
[9]Miss. Code §§ 6132-01—6132-51 (1942).
[10]Garza v. DeMontalvo, 147 Tex. 525, 217 S.W.2d 988 (1949), where the court said, "Our conclusion here is supported by decisions holding that where a portion of leased premises is subsequently conveyed by the lessor, the royalties will not be apportioned on the basis of acreage in the absence of an express contract to that effect, but the owner of each separate tract will be entitled to receive royalties only on oil and gas produced from his tract. This is the settled law in Texas."
[11]Mueller v. Sutherland, 179 S.W.2d 801 (Tex. Civ. App. 1943). *Contra:* Grelling v. Allen, 218 S.W.2d 896 (Tex. Civ. App. 1949).
[12]Loeffler v. King, 228 S.W.2d 201 (Tex. Civ. App. 1950). Peterson v. Grayce Oil Co., 37 S.W.2d 367 (Tex. Civ. App. 1931), *aff'd.*, 128 Tex. 550, 98 S.W.2d 781 (1936).
[13]See note 11 *supra.*
[14]*Ibid.*

claim deed to the vacant lot and asking that the deed be reformed so as to convey to her the property intended. The circuit court granted reformation and discharged plaintiff's general order of attachment of the apartment house. The court of appeals held that the reformation did not defeat the attachment lien of plaintiff as a bona fide creditor where the lien was levied on the property while it stood in the name of defendant. *Eastern Kenutcky Production Credit Association v. Scott,* 247 S.W.2d 983 (Ky. 1952).

According to the general rule, when an instrument is reformed it is retroactive to the date of the original unless a subsequent bona fide purchaser for value would be injured thereby.[1] In the majority of our courts intervening judgment creditors are not protected by the above rule because they are not cosidered bona fide purchasers for value.[2] It has been held that the equity of reformation is superior to the claims of judgment or attachment creditors because the equity attaches to the property upon the execution of the original deed and is thereby prior in time to the judgment.[3] The Kentucky court in this case, however, said that the credit association's equity was superior because Mildred had a duty to see that there was no error in her deed.

Possession of land constitutes notice of the occupant's interest to subsequent purchasers or encumbrancers although his deed contains an erroneous description of the land, and reformation of his deed will be granted as against subsequent purchasers or encumbrancers.[4] It has been generally held that possession by a tenant is sufficient notice of his landlord's claim.[5] This court in the subject case recognizes the above rules. However, in this case the court said that the possession of the apartment by the tenant was not sufficient to put the creditor on notice because an apartment house is customarily occupied by tenants, and here the same tenants remained when Mildred assumed ownership. This is based on the reasoning that there must be a change in possession to give notice of a change in ownership. It has been held in some jurisdictions that continued possession by a tenant under an agreement with the new owner is sufficient notice of the new owner's rights in the property.[6]

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[1]Beason v. Duke, 246 Ala. 387, 20 So.2d 717, 718 (1945); Mason v. Jarrett, 218 Ark. 147, 234 S.W.2d 771, 773 (1950); Smith v. Pattishall, 127 Fla. 474, 176 So. 568, 572 (1937); First Nat'l Bank v. Williamson, 273 Ky. 116, 115 S.W.2d 565, 568 (1938); Globe & Republic Ins. Co. of America v. Shields, 170 Tenn. 485, 96 S.W.2d 947 (1936); Johnson v. Terry, 128 W. Va. 94, 36 S.E.2d 489 (1945); 76 C.J.S., REFORMATION OF INSTRUCTIONS, § 93.

[2]Federal Land Bank v. Kenshalo, 258 Ill. App. 1 (1930); Davis v. Bunnell, 207 Iowa 1181, 225 N.W. 6 (1929); Crossett v. McQueen, 205 N.C. 48, 169 S.E. 829 (1933).

[3]Beckins v. Hahn, 114 Neb. 371, 207 N.W. 515 (1926).

[4]Graham v. Brand, 168 Ga. 356, 148 S.E. 84 (1929); Pearce v. Osterman, 343 Ill. 175, 175 N.E. 416 (1931); Russell v. Scarborough, 155 Miss. 508, 124 So. 648 (1929); Luker v. Moffett, 327 Mo. 929, 38 S.W.2d 1037 (1931); Deubel v. Dearwester, 36 Ohio App. 60, 172 N.E. 640 (1930); Robert Oil Corp. v. Jones, 23 S.W.2d 472 (Tex. Civ. App. 1930); Miles v. Craig, 147 Wash. 530, 266 Pac. 182 (1928).

[5]Chestnut v. Weeks, 180 Ga. 701, 180 S.E. 716 (1935); Wilkins v. Bevier, 43 Minn. 213, 45 N.W. 157 (1890); Healey v. Wastenberg, 47 Wyo. 375, 38 P.2d 325 (1934).

[6]Mallett v. Kaehler, 141 Ill. 70, 30 N.E. 549 (1892); Hannon v. Seidentopf, 113 Iowa 658, 86 N.W. 44 (1901); Jones v. Sharp, 183 Okla. 22, 79 P.2d 585 (1938); Bell v. Protheroe, 199 Okla. 562, 188 P.2d 868 (1948); Duff v. McDonough, 155 Pa. 10, 25 Atl. 608 (1893); Simmons v. Eakin, 54 S.W.2d 1045 (Tex. Civ. App. 1932). *Contra:* Wiggins v. Stewart Bros., 215 Ala. 9, 109 So. 101 (1926); Feinberg v. Stearns, 56 Fla. 279, 47 So. 797 (1908); Penrose v. Cooper, 88 Kan. 210, 128 Pac. 362 (1912); Veazie v. Parker, 23 Me. 170 (1843); Hull v. Galfill Oil Co., 263 Mich. 650, 249 N.W. 24 (1933); Loughridge v. Bowland, 52 Miss. 546 (1876); Kalmia Realty & Ins. Co. v. Hardy, 164 Miss. 313, 145 So. 506 (1933).

It has also been held that continued possession by one of several co-tenants of land after acquiring the interest of other co-tenants by an unrecorded deed is notice to a subsequent purchaser of the interest claimed by the occupant.[7] This holding can only be reached by placing a duty on the purchaser, of land not in the possession of the grantor, to make inquiry of the occupants as to their interests.

Elwood L. Edwards

Tort—Liability for Pre-natal Injuries

Defendant negligently injured plaintiff when he was a nine month old fetus, viable at the time, and was actually born later. Held: Plaintiff is entitled to recovery. In quoting from the dissenting justice of the appellate division, the court said: "To deny the infant relief in this case is not only a harsh result, but its effect is to do reverence to an outmoded, timeworn fiction not founded on fact and within common knowledge untrue and unjustified." *Woods v. Lancet,* 303 N.Y. 349, 102 N.E.2d 691 (1951).

The problems that have arisen in regard to tort liability for injuries to infants *en ventre sa mere* are comparatively recent. The first case, *Dietrich v. Inhabitants of Northampton,*[1] arose in Massachusetts in 1884 under a wrongful death statute. A mother was injured and the subsequent premature birth brought on by the injury permitted the four or five month infant to survive only a matter of minutes. Recovery was denied.

The issue next appeared before the Irish court in 1890, where the facts involved an injury to a pregnant woman on a railway car. The infant suffered deformities because of the injury and sued the railroad for its negligence, but was denied relief.[2]

These early cases are typical of the circumstances in which the problem of liability for pre-natal injuries arise, and the weight of authority in this country supports their holdings.[3]

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[7]Seawell v. Young, 77 Ark. 309, 91 S.W. 544 (1905); Ellis v. Everett, 79 Fla. 493, 84 So. 617 (1920); Wren v. Wren, 199 Ga. 851, 36 S.E.2d 77 (1945); Farmers' Nat'l Bank v. Sperling, 113 Ill. 273 (1885); Van Gondy v. Tandy, 272 Ill. 319, 111 N.E. 1020 (1916); Schmidt v. Steinback, 193 Mich. 640, 160 N.W. 448 (1916); Boedefeld v. Johnson 201 S.W. 1027 (Tex. Civ. App. 1918).*Contra:* Oxford Junction Savings Bank v. Hall, 203 Iowa 320, 211 N.W. 389 (1926); Parker v. Osgood, 3 Allen 487 (Mass. 1862); Dutton v. McReynolds, 31 Minn. 66, 16 N.W. 468 (1883); Hilts v. Stroh, 127 App. Div. 944, 112 N.Y.S. 30 (1908); Ildvedsen v. First State Bank, 24 N.D. 227, 139 N.W. 105 (1912); Harrison v. Crome, 110 Okla. 87, 236 Pac. 388 (1925); Martin v. Thomas, 56 W. Va. 220, 49 S.E. 118 (1904).

[1]138 Mass. 14, 52 Am. Rep. 242 (1884).

[2]Walker v. Great Northern Railway of Ireland, 28 L.R.Ir. 69 (1890).

[3]Stanford v. St. Louis-San Francisco R.R., 214 Ala. 611, 108 So. 566 (1926); Allaire v. St. Luke's Hospital, 184 Ill. 359, 56 N.E. 638 (1900) (strong dissent by Judge Boggs); Smith v. Luckhardt, 299 Ill. App. 100, 19 N.E.2d 446 (1939). Massachusetts reaffirmed its position in the *Dietrich* case in Bliss v. Passanesi, 326 Mass. 461, 95 N.E.2d 206 (1950) (But the court said: "We do not intimate what our decision would be if the question were presented for the first time."). Massachusetts again reaffirmed the *Dietrich* case in the latest decision on the subject, Cavanaugh v. First Nat'l Stores, 107 N.E.2d 307 (Mass., 1952). Newman v. City of Detroit, 281 Mich. 60, 274 N.W. 710 (1937); Buel v. United Ry., 248 Mo. 126, 154 S.W. 71 (1913); Drabbels v. Skelly Oil Co., 155 Neb. 17, 50 N.W.2d 229 (1951); Stemmer v. Kline, 128 N.J.L. 455, 26 A.2d 489 (1942); Berlin v. J. C. Penny, Inc., 339 Pa. 547, 16 A.2d 28 (1940); Gorman v. Budlong, 23 R.I. 169, 49 Atl. 704 (1901); Magnolia Coca Cola Bottling Co. v. Jordan, 124 Tex. 347, 78 S.W.2d 944 (1935);

The two basic reasons given for the denial of recovery are: (1) no duty to a person who is not in existence at the time; and (2) difficulty of proving any casual connection between negligence and damage.[4] The source of the first reason seems to lodge in the philosophical difficulties underlying the decisions, one of which is whether an unborn infant has legal existence.[5] Men have also pondered the question of the inherent good or evil in an unborn child. It is submitted that the former question belongs in the realm of the latter, and the answer, if there be an answer, should not dictate the basis of recovery for pre-natal injuries.

The causation reason is more than theoretical in that this type of case makes it difficult to show causal relationship, and the practical danger of fictitious claims asserts itself. But why should the law deny a remedy when the difficulty is one of fact, not law?

An increasing minority view has begun to expose the fallacies originating in the *Dietrich* case.[6] Our fundamental tenet of no wrong without a remedy seems to have its effect upon the presentation of this problem.

In the subject case, an excellent example is afforded by which to examine the general rationale of the courts allowing recovery.[7]

The question of lack of precedence arose, and the court disposed of the issue in part by a quotation from Winfield's article in the *University of Toronto Law Journal,* which says: ". . . if that were a valid objection, the common law would now be what it was in the Plantagenet period."[8]

Causation was disposed of by saying that "it is an inadmissable concept that uncertainty of proof can ever destroy a legal right." And it is pointed out the same difficulty exists in thousands of other negligence cases.

Lipps v. Milwaukee Electric Ry. & Light Co., 164 Wis. 272, 159 N.W. 916 (1916) (Involved injury to non-viable infant, and the court carefully limited the decision to a non-viable fetus saying: "Very cogent reasons may be urged for a contrary rule where the infant is viable. . . .") The Restatement adopts the conclusion of the majority. RESTATEMENT, TORTS § 869 (1939).

[4]PROSSER, HANDBOOK OF THE LAW OF TORTS 189 (1st ed. 1941).

[5]Blackstone said: "Life . . . begins in contemplation of law as soon as an infant is able to stir in his mother's womb. For if a woman is quick with child, and by a potion or otherwise killeth it in her womb, or if anyone beat her, whereby the child dieth in her body, and she is delivered of a dead child, this though not murder, was, by the ancient law, homicide or manslaughter." 1 BL. COM. 129 (3d ed., Cooley, 1884). "Biologically speaking, the life of a human being begins at the moment of conception in the mother's womb." 27 AM. JUR., INFANTS § 3.

[6]Scott v. McPheeters, 33 Cal. App. 2d 629, 92 P.2d 678 (1939) (decided by District Court of Appeal, 3d Dist.), *hearing denied,* 33 Cal. App. 2d 629, 93 P.2d 562 (1939); Tucker v. Carmichael, 208 Ga. 201, 65 S.E.2d 909 (1951); Damasiewicz v. Gorsuch, 79 A.2d 550 (Md., 1951) (says recovery should be allowed even if the infant was not viable at the time of the injury); Gerkennes v. Corniea, 229 Minn. 365, 38 N.W.2d 838 (1949); Williams v. Marion Rapid Transit, Inc., 152 Ohio St. 114, 87 N.E.2d 334 (1949); Jasinsky v. Potts, 153 Ohio St. 529, 92 N.E.2d 809 (1950); Bonbrest v. Katz, 65 F. Supp. 138 (D. C. 1946). Canada also allowed recovery in Montreal Tramways v. Levielle, 4 Dom. L.R. 337 (1933) (the first case to allow recovery).

[7]A prior New York decision had denied recovery under similar circumstances, and it is therefore overruled by the subject case. Drobner v. Peters, 232 N.Y. 220, 133 N.E. 567 (1921).

[8]P.H. Winfield, *The Unborn Child,* 4 UNIV. OF TORONTO L. J. 292 (1942). For a later discussion of the subject see Gaines, *The Infant's Right of Action for Pre-natal Injuries,* WIS. L. REV. 518 (1951).

The answer to the legal existence problem is somewhat restricted in the subject case because the infant was viable, and the holding is strictly limited to a viable fetus.

The subject case represents another marker in an improved road away from the logically dubious position of the *Dietrich* case. Though it carefully limits recovery to a viable infant, the issues are squarely faced and the fallacies implicit in denying recovery to meritorious actions for pre-natal injuries are clearly shown.

Albert A. Covington

Workmen's Compensation—Horseplay—Interpretation of Employment

A laundry employee, while on his route, was shot and killed by his customer as he was picking up laundry on the customer's porch. In a workman's compensation proceeding the customer-wife testified she had previous sexual relations with the deceased. Held: Dependency compensation was awarded. *Brookhaven Steam Laundry v. Watts,* 55 So.2d 381 (Miss. 1951), reversed, sustaining a suggestion of error, 59 So.2d 294 (Miss. 1952).

On the same day the subject case was decided the Mississippi Supreme Court allowed compensation in a similar situation where an employee while engaging in "horseplay" received a blow from a shovel, causing considerable injury. *Mutual Implement & Hardware Ins. Co. v. Pittman.*[1]

The inconsistent decisions of the court are strikingly noticeable, for in the *Pittman* case the court construed the Workmen's Compensation Act[2] liberally, while moments before sustaining a suggestion of error in the *Brookhaven* case.

The court was apparently concerned about interpreting the words "arise out of" in the statute. They chose to give this phrase a narrow meaning, following the common law doctrine of "within the scope of employment."

The ancient doctrine of the *McNicol's Case*[4] set the test as follows: "The causative danger must be peculiar to the work and not common to the neighborhood." This reasoning has been sustained by the minority of jurisdictions. Contrary to the *McNicol's* test there arose the "position and locality" test of *Thom v. Sinclair,*[6] setting the pattern for a more liberal interpretation of the workmen's compensation acts.[7] With the realization that all men are of different natures and that common employment brings about a meeting of these natures, the position and locality test grew in acceptance.[8] More recently the law has been somewhat settled with the Supreme Court of the United States holding, "All that is required is that the 'obligations or conditions' of employment create the 'zone of special danger' out of

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[1]59 So.2d 547 (Miss. 1952).
[2]Miss Laws 1948, c. 354, § 1 *et seq.*
[3]Bluegrass Pastureland Dairies v. Meeker, 268 Ky. 722, 105 S.W.2d 117 (1937); January Wood Co. v. Schumacher, 231 Ky. 705, 22 S.W.2d 117 (1929).
[4]McNicol's Case, 215 Mass. 497, 102 N.E. 697 (1913).
[5]Hartford Accident & Indemnity Co. v. Industrial Commission, 66 Ariz. 259, 186 P.2d 959 (1947); Brooks-Scanlon Inc. v. Lee, 44 So.2d 650 (Fla. 1950); Schlange v. Briggs Mfg. Co., 326 Mich. 552, 40 N.W.2d 454 (1950).
[6]A.C. 127, 142, 143 (1917).
[7]Deemer Lbr. Co. v. Hamilton, 211 Miss. 673, 52 So.2d 634 (1951).
[8]Cardille v. Liberty Mutual Ins. Co., 330 U.S. 469 (1947); Industrial Comm., 62 Ariz. 398, 158 P.2d 511 (1945); Accident & Indemnity Co. v. Cardille, 72 App. D.C. 52, 112 F.2d 11 (1940), *cert. denied,* 310 U.S. 649 (1940).

which the injury arose."[9] Can a court with consistency say that the compensation act requires a broad and liberal construction, and then work out a theory of no-liability based on a narrow interpretation of the statute? Even where there is a dual purpose of the employee, the majority view today is that only one of the purposes need be a business one[10] and this will suffice for compensation.

Does it make any difference if the employee is at fault? The answer of the great weight of authority is that fault is no defense under the compensation acts.[11] Regardless of fault, assaults even of a personal nature are compensable by courts holding to the liberal trend.[12] "Horseplay," to the extent of breaking a known and existing rule, has been held compensable,[13] even where the employee happens to be the instigator.[14]

The Supreme Court of Mississippi in announcing its decision in the subject case is not consistent with the view it adopted in the *Pittman*[15] case the same day.

Alvin Binder

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[9]O'Leary Brown Pacific v. Maxon Ins. Co., 340 U.S. 504 (1951); Southern Stevedoring Co. v. Henderson, 175 F.2d 863 (5th Cir. 1949).

[10]State Employees' Retire Sys. v. Industrial Acc. Comm., 217 P.2d 992 (Cal. App. 1950); Phoenix Indemnity Co. v. Industrial Accident Commission, 31 Cal.2d 856, 193 P.2d 745 (1948); Kaplan v. Alpha Epsilon Phi Sorority, 230 Minn. 547, 42 N.W.2d 342 (1950).

[11]Dillon's Case, 324 Mass. 102, 85 N.E.2d 69 (1949); Newell v. Moreau, 94 N.H. 439, 55 A.2d 476 (1947); Commissioner of Taxation (*In re* Callahan) v. Bronx Hospital, 276 App. Div. 708, 97 N.Y.S.2d 120 (1950).

[12]Riedel v. Havemeyer, 277 App. Div. 957, 99 N.Y.S.2d 628 (1950); Hegler v. Cannon Mills Co. 224 N.C. 669, 31 S.E.2d 918 (1944); Horovitz, *Assaults and Horse-Play under Workmen's Compensation Laws,* 41 ILL. L. REV. 311 (1946).

[13]Burns v. Merrit Engineering Co., 302 N.Y. 131, 96 N.E.2d 739 (1951).

[14]Montpetit v. Standard Shade Roller Corp., 100 N.Y.S.2d 640 (1950).

[15]See note 1 *supra* at 556. Justice Roberds in his dissent, recognizes this inconsistency: "We have crossed the Rubicon." Although a believer in the restrictive theory, he is apparently perplexed with the behavior of the court.

RECENT BOOKS

ESTATE TAX HANDBOOK. By J. K. Lasser, Matthew Bender & Company, New York City, 1951. Pp. 846. $15.00.

The *Estate Tax Handbook* is a compilation of twenty-one articles, each of which is directed to a consideration of the rather meaty subject matter indicated by the title of the particular article.

A description of the physical structure of the book may be helpful. There is a table of contents listing the articles by their titles and indicating the beginning page number of each article. This is followed by an introduction embracing thirty pages by J. K. Lasser, who edited the *Estate Tax Handbook*, and then the twenty-one separate articles, some of which have an attached bibliography. A rather substantial subject index of twenty-seven pages completes the book.

A listing of the titles of the articles, the length thereof and the names of the respective authors will give some impression of the merit of the work and the scope of the treatment accorded a particular subject.

INTRODUCTION (RANDOM NOTES OF ESTATE PLANNING) by J. K. Lasser....30 pages

HOW TO COORDINATE BUSINESS TRANSACTIONS WITH ESTATE PLANNING by Charles A. Morehead....36 pages

CONTEMPLATION OF DEATH: WHAT IT IS AND HOW TO AVOID IT by Martin Atlas....33 pages

HOW TRUSTS SHOULD BE PLANNED TO HELP ESTATE PLANNING by Seymour S. Mintz and Robert H. Eifler....76 pages

HOW TO AVOID TRUST "TRANSFERS TAKING EFFECT AT OR AFTER DEATH" by Samuel J. Foosaner....37 pages

HOW TO AVOID OTHER "TRANSFERS INTENDED TO TAKE EFFECT AT DEATH" by Samuel J. Foosaner....38 pages

HOW TO USE POWERS OF APPOINTMENT IN ESTATE TAX PLANNING by Benjamin Harrow....28 pages

PROPERTY OWNED IN JOINT TENANCY AND TENANCY BY THE ENTIRETY by Harry J. Rudick....29 pages

HOW GIFTS AND ESTATES ARE TAXED IN COMMUNITY PROPERTY STATES by Frank B. Appleman....20 pages

HOW TO INTEGRATE LIFE INSURANCE INTO ESTATE TAX PLANNING by Raymond W. Hilgedag....33 pages

ESTATE TAX VALUATION by Roger K. Powell....43 pages

HOW RESTRICTIVE STOCK PURCHASE AGREEMENTS WILL AID ESTATE PLANNING by Sydney A. Gutkin....32 pages

HOW TO USE TAX TECHNIQUES IN THE DRAFTING OF WILLS AND TRUSTS by George J. Laikin....43 pages

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How to Deal with "Terminable Interest" Problems Arising Upon the Death of a Partner by Arnold L. Cutler....37 pages

How to Plan for the Income of an Estate by Wilbur H. Friedman....31 pages

How to Prepare an Estate Tax Return by Elmo H. Conley....30 pages

It is appropriate to state at this point that if the use of the word "Handbook" in the title of the *Estate Tax Handbook* creates the impression that this book is an exposition of rudimentary principles of federal estate taxation and the application of such principles to rather simple factual situations, then this impression should be dispelled. The *Estate Tax Handbook* is distinctly not a book for those who have had only limited contact with federal tax matters. Rather, it is a helpful stepping stone to a seasoned tax practitioner in conducting the exhaustive research inherent in finding the solution to a vexatious problem. The experienced tax attorney will not find himself in unfamiliar territory in any of the articles, but he will profit from the intense and highly concentrated light thrown on the specific subjects by their respective authors; and each of the articles conveys the feeling of sustained and cohesive intellectual effort. Even so, the lawyer who gains most by reading the articles will be the one who is stimulated to continue his research by an independent analysis of the pertinent cases, the law and regulations and various departmental rulings and opinions.

It is not possible within the limits of a book review to discuss all of the articles or even consider any one of them with the completeness which their excellence merits. However, some comment, essentially descriptive, on a few of the articles is offered as affording a limited insight to the *Estate Tax Handbook*.

The Introduction by J. K. Lasser, entitled "Random Notes on Estate planning," is described by the author as "scribblings to express current estate tax planning." Notwithstanding the somewhat deprecatory appellation given by the author, his random notes provide some very concise thoughts on eminently practical subjects. These notes are, in the main, presented in an outline form which serves to emphasize their realistic suggestions and admonitions.

It should be borne in mind that estate tax planning concerns itself with the living but anticipates the event of death. This is made amply clear by Mr. Lasser in his Notes on Preparing for Stock Valuation; Notes on Financing the Estate Tax; Notes on Real Estate Values; Notes on Personal Insurance; and Notes on Miscellaneous Property, which are five of the ten subjects discussed in the Introduction.

The random notes of Mr. Lasser also serve to introduce a theme which continues throughout the book. This is the necessity for obtaining from a client the most

complete statement of his domestic status, his desires with respect to the future of his family and a comprehensive analysis of his financial condition. All too frequently an attorney will not get all the information he needs in order to serve best his client's interests because he feels that he is pressed for time by his client or because of a natural reluctance to make the client feel that the attorney is prying into personal matters. Such attorney may be assured that if he is ever interrogated by an examining revenue agent after the death of the client, the agent will feel no such hestitation.

"How to Coordinate Business Transactions with Estate Tax Planning," by Charles H. Morehead, attorney of Miami, Florida, is the opening article in the book. This excellent article is broken into five sections. Section 1 considers the status of, and the planning which may be done for, a client engaged in business as a sole proprietorship.

Section 2 of the article treats with partnership transactions and points out that partnerships offer a greater basis for planning than sole proprietorships.

Sections 3 and 4 deal with corporate transactions and the advantages of the corporate entity over the sole proprietorship or partnership. These are comprehensive sections and give much support to the author's advocacy of the corporate structure as affording the greater flexibility in estate planning.

Section 5 of the article examines Business Transactions Outside the Realm of Business Organizations. Among other types of property ownership discussed, tenancies by the entirety are compared with tenancies in common and the tax benefits of the latter are illustrated. The tax implications of joint tenancy and tenancy by the entirety are considered more exhaustively in an article by Harry J. Rudick limited to this subject and appearing at page 285 of the *Estate Tax Handbook*.

"Estate Tax Valuation," by Roger K. Powell, attorney of Columbus, Ohio, is the tenth article in the *Estate Tax Handbook*. The author of this article cannot be charged with overstatement when he says at the outset: "Nothing in the estate tax field pays so large a dividend as a thorough knowledge of *what* to do with valuation problems and *how* to do it."

After discussing valuation in general, the author then takes up the matter of valuation of specific types of property. The valuation of real estate is dealt with adequately and there is an outstanding exposition on the valuation of stocks and bonds. The subjects of valuation of future interests, valuation of interest in trusts, valuation of patents and copyrights and other miscellaneous valuation questions conclude the article.

"How to Prepare an Estate Tax Return," by Elmo H. Conley, attorney of Los Angeles, is the final article in the *Estate Tax Handbook*. Of necessity, there is some overlapping of matters discussed in preceding articles in the book, because the estate tax return should reflect the end result of careful and intelligent estate planning.

The author dedicates several pages to the Philosophy of Preparing the Return—an important matter replete with possibilities of benefits or detriments.

The proper philosophical approach of tax practitioner and revenue agent alike, according to the author, should be the conscientious effort to arrive at the correct tax, not the highest possible tax, nor the lowest possible tax. Certainly, it is the wiser course for the tax practitioner to so conduct himself as to instill in

the examining agent the maximum amount of confidence in the practitioner personally and in his work.

The articles described briefly herein were selected for what is actually only passing comment because they appeared to concern subjects that may have the more general appeal for readers of this review. The *Estate Tax Handbook* is an excellent work, but its benefits can be obtained only by careful study.

*John R. Stivers**

THE TAMING OF THE NATIONS: A Study of the Cultural Bases of International Policy. By F. S. C. Northrop. Macmillan, New York, 1952. Pp. 362. $5.00.

There is a human tendency to deal with international problems in a piecemeal, trial-and-error fashion—usually with too many errors. In Professor Northrop we find a responsible philosopher turning his attention not to the problems of metaphysics and epistemology as such, but to the fundamental theoretic problems underlying international conflict. The physical scientists have learned that he who analyzes the sense world and brings forth a successful theory has accomplished far more than he who builds a city. The work of Professor Northrop should prove to be more successful in leading to long-run solution of the world's problems than the efforts of a thousand diplomats.

The basic theory of Professor Northrop is that if we are to devise any reconciliation between the nations of the world, it must be along cultural rather than national lines. He sees three main problems.

> "First, the normative inner order of beliefs and habits which is the living law of each national or cultural group in the world must be specified. Second, the relation between the normative ideology of each nation or cultural group and that of all other nations and cultural groups must be determined. In certain cases this relationship will be found to be that of logical incompatibility and contradiction. This means that no single theory of the way to relate nations can be specified as a universal policy or panacea applicable to all nations. . . . The third task will be that of framing foreign policy and international law in the light of these international living law findings."

Pearl Harbor, Hiroshima and Korea dramatically illustrate the preparation of the world for a realistic approach to international and intercultural reconciliation. Pearl Harbor definitely proved that isolationism is permanently dead. Hiroshima has convinced the hearts of the world's millions that the atomic fury of war must come to an end, by some means or other. And Korea constitutes an endeavor to prove that aggression can be prevented by united world action under law. Had the United Nations not acted decisively as it did in Korea, Northrop asserts that by now World War III would be in full swing. He asserts evidence that Moscow's China had definite plans for the rest of Asia after winning in Korea. Our failure to act in Korea would have encouraged China in further aggression, and anti-communist Asia would have been disheartened simultaneously. Finally the invasion of India would have touched off the third world war.

The Indian attitude is puzzling. Its rectification is crucial. The fact is that India is faced by a dilemma. She must choose between her traditional Asian ways and the newer western democratic universal legal ways. Gandhi rejected both the

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*Lowrance & Stivers, Memphis, Tennessee.

older Aryan ways of freedom, individuality and law, and the modern western democratic universal legal way. He chose the mystical, non-violent, mediatorial way of Buddhism, the Baghavad-Gita, Taoism, and the Confucian "jen," or "man-to-manness." This is the Asian way, founded upon the village-family way of intuitive justice. It still lures India away from world realities.

India ought to realize that her interests lie with the United Nations rather than with Moscow's China. In fact, Premier Nehru, addressing the United States Congress less than a year before Korea, pledged India's support of the democratic nations of the world in resisting aggression and cultivating liberty, equality and progress. Yet when aggression did come India dissented from the United Nations action and has continually sought to mediate what cannot be mediated. Mediation is impossible between a policeman and an assassin. To yield even partially to Moscow's China today would be to invite further aggression. The principle involved is the defense of the institution of law.

Indian press and public opinion overwhelmingly support and inspire Nehru's attitude. The reason for this is twofold: India remembers past western imperialism and India remembers Mahatma Gandhi's teaching of non-violence. The first memory makes India suspicious of United Nations troops—that is, *western* troops—on Asiatic soil. The second memory reminds her that Asian culture is based on a family-village type of sociology and on the principle of mediation rather than on the idea of universal law. But India must also realize that there are ancient Aryan and modern English elements deeply embedded in her culture. She is quite Aryan in her dealings with Kashmir, Hyderabad, the princely states and Pakistan. And her revolt from England was based largely on her heritage from her British masters who taught her Locke's philosophy of freedom and self-government.

Our difficulty in winning the heart of India lies in the deepseated Asian element of her culture. This she shares with Taoist-Confucian China and the Buddhist East. The Asian mentality regards particulars as transitory and unreal. The real for Asians is the intuitively apprehended aesthetic continuum, the all in which the individual is swallowed up. They reject the definite conceptual law or "logos" of the West while practicing intuitive justice. Even western gadgets seem beyond their mastery, because they do not think in terms of the scientific laws and principles which are expressed in those gadgets. The only satisfactory way to teach orientals the successful use of western technology is through a philosophical approach. When they get the basic western concept, then they can grasp the approach. When they get the basic western concept, then they can grasp the particulars as well as we can, Northrop asserts.

Islam does not suffer the same dilemma as India does. For Islam is not essentially Asian. She shares not only the Hebrew-Christian religious tradition with us, but also our Greek theoretic conceptual science. She taught the Christian West much about Aristotle. Islamic resurgence today is most vital. It is quite modern, scientific, and western rather than Asian. Its tendency is not nationalistic but cultural. These facts made it impossible for Moslem India to accept unitary political intergration with independent Hindu India. Islamic India would have been happy to join with Hindu India in a federal union which recognized cultural-political autonomy. Such a pattern would have been feasible not only for India but also for world order today.

The only way to defend free culture today is through the recognition of cultural pluralism. In this respect we must learn a lesson from Moscow on how to be smart.

Moscow's present power has been gained not by putting Russian troops on foreign soil, nor by giving economic aid. She has gained her power by exporting ideas and by identifying herself with the cause of indigenous culture. As Mao's communist soldiers marched into Peking they lustily sang the folksongs which the Chinese people loved. The Pekingese were overjoyed in welcoming them. There is a deep insincerity on the part of communism in thus identifying itself with indigenous culture. For when once they get control over a culture they fully intend to overthrow it and replace it with Marxist culture. Why cannot the non-communist world adopt the *sincere* and systematic policy of encouraging indigenous cultures everywhere, thus winning friends and influencing the world's future at the grass roots?

Western civilization must make a decisive contribution to world culture in terms of its spiritual elements and its progressiveness. The spiritual roots of western culture are Hebrew-Christian-Greek-Stoic-Roman. The Greek contribution was its philosophy and science, even more significantly than its art. From earliest times its science was formulated in terms of supersensuous laws comparable with their completer fulfillment in Einstein's general theory of relativity. Stoic ethical law was likewise conceptual and universal. From this came Roman law and Mediterranean Islamic law and even modern international law. United States constitutionalism is conceptual and universal, subordinating even the President and Congress to its principles. Europe, including German-Marxist Russia, subscribes to the idea of conceptual universal law having particular applications.

Unfortunately western culture was fragmented in the revolt against Roman absolutism. In this revolt they confused Roman absolutism with Roman constitutionalism. The Roman church perpetuated this confusion and chose to retain the absolutism, while Protestant Europe in rebelling against the absolutism destroyed also Roman universalism, fragmenting into nationalities. Now we need to restore constitutional universalism as developed by Roman law. The countries of Western Union, now well on the road to such restoration, come close to reviving the actual boundaries of Charlemagne's Roman Empire—a fact which Northrop regards as more than a coincidence.

Northrop distinguishes seven principal culture areas in the world. We have mentioned the Asian and the Islamic. There are also the Marxist-Russian and its satellites, the western European Catholic, The British commonwealth with its modified Protestantism making it culturally distinct from western Europe and therefore justifying its aloofness from the union which it is encouraging there, and then the American-Latin-American culture of independence. The seventh type, which he does not discuss, is the primitive African culture. The east and north European Protestant culture is in a precarious state, partly dominated by Marxist Russia today but probably destined to coalesce with British or American culture.

Some of these main cultures are mutually compatible while others are not. The only one which is entirely incompatible with the others is the Russian, because of its Marxist basis. Marxism permits no compromise or synthesis. It is revealed truth and cannot be compromised. Law as between Marxist and non-communist nations is impossible, because a basic policy of communist procedure is to work for the overthrow of non-communist law everywhere. They negotiate only to deceive. For example, they will compromise their proletarian policies by taking peasants into the government, but as soon as they are strong enough without them they will purge them. This is official communist doctrine as well as actual practice, and we need not be deceived about it.

The desperate world situation is revealed in the estimate of the Atomic Energy Commission that it will take between two hundred and a thousand atomic bombs exploded within a brief period of time to destroy all human life on the earth. The next war must be avoided by all means. But the present United Nations Charter is too vague to be effective. It must be amended to provide positive law to fit the living law of the various cultures. This guarantee of living law will eliminate the excuse for great-power veto.

The effort to impose a single system of law on all cultures may be feasible after a considerable period of cultural growth, but definitely is not possible yet. Meanwhile we need a system of law that will prevent the explosion of another bomb. Therefore we must adopt legal pluralism, guaranteeing and encouraging each culture area in the exercise of its own system of law.

Our reliance on power politics will continue to be ineffective. The word power, in this connection, is ambiguous and offensive. It is no wonder that the Indians will not go along with us in the game of power politics, in which India is described as the "weak underbelly of Asia." Actually our foreign policy is not based simply on power, however that may be defined. Secretary Acheson followed an eclectic foreign policy which placed the United States in a position of thorough undependability. Yet the peoples of the world continue to believe in the American people. If we want to employ real power in our foreign policy, it must be by encouraging indigenous cultures everywhere to progress in terms of their own insights. The Division of Cultural Relations should be the very heart of our State Department.

Cultures are not static entities. They are in continual process of re-formation. In this process of re-formation some one homogeneous living law must triumph for the sake of a united world. Only two such systems are in real competition with each other today, namely, that of the U.S. and that of the U.S.S.R. Which will it be? The United States has moved from liberty-loving Philadelphia of 1775 to the earth-circling Cosmopolis envisioned by the ancient Stoics and Roman law. Let us not stop short of the fulfillment of that dream.

One can understand, after reading this book, why it is that F. S. C. Northrop holds the dual position of Professor of Philosophy and Law in the Department of Philosophy and the Law School of Yale University.

There is no irrelevant or unimportant matter in *The Taming of the Nations.* Certain chapters are well worth reading quite apart from the main purpose of the book; such as the one on "The Resurgence of Islam" and that on "The Theory and Practice of Soviet Russian Communism." The chapter on "The Spiritual Foundations of Western Civilization" is most stimulating. In fact, I would not miss reading this entire book for any reason.

*Quinter M. Lyon**

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*Chairman of Department of Philosophy and Professor of Philosophy, University of Mississippi.

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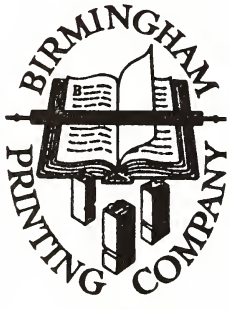

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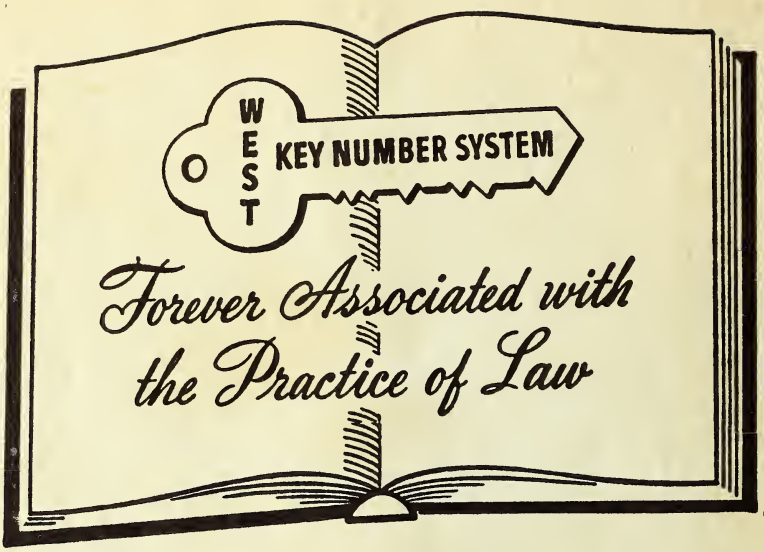

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